

# Inspector General

United States  
Department of Defense



Host Nation Support of U.S. Forces in Korea

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## Acronyms and Abbreviations

FED	U.S. Army Corps of Engineers, Far East District
FMC	Financial Management Center
HNS	Host Nation Support
KN	Korean National
LCS	Labor Cost Sharing
NAF	Nonappropriated Fund
ROK	Republic of Korea
U.S.C.	United States Code
USFK	U.S. Forces Korea



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-4704

August 25, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF  
FINANCIAL OFFICER  
COMMANDER, U.S. FORCES KOREA  
COMMANDER, U.S. AIR FORCES KOREA  
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL  
MANAGEMENT AND COMPTROLLER)  
NAVAL INSPECTOR GENERAL  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE

SUBJECT: Host Nation Support of U.S. Forces in Korea  
(Report No. D-2008-118)

We are providing this report for your review and comment. We performed the audit in response to a request by the Commander, U.S. Forces Korea. We considered management comments on a draft of the report in preparing the final report.

Comments to the recommendations on a draft of this report conformed to the requirements of DoD Directive 7650.3. However, the Chief of Staff, U.S. Forces Korea, responding for the Commander, U.S. Forces Korea, provided comments on finding B that required an additional recommendation. Therefore, we request comments on Recommendation B.2. from the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Director, Defense Finance and Accounting Service and the Commander, U.S. Forces Korea by September 25, 2008.

Please provide comments on the new recommendation that conform to the requirements of DoD Directive 7650.3. If possible, send management comments in electronic format (Adobe Acrobat file only) to [AudJ&OO@dodig.mil](mailto:AudJ&OO@dodig.mil). Copies of the management comments must have the actual signature of the authorizing official for your organization. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8863 (DSN 664-8863) or Mr. Gordon Uscier at (703) 604-9194 (DSN 664-9194). If you desire, we will provide a formal briefing on the results.

  
Donald A. Bloomer  
Deputy Director  
Joint and Overseas Operations





# Results in Brief: Host Nation Support of U.S. Forces in Korea

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## What We Did

At the request of the Commander, U.S. Forces Korea, we evaluated the controls over the Host Nation Support that U.S. Forces Korea receives from the Republic of Korea. We focused on the cash and in-kind contributions outlined in the Special Measures Agreement between the United States and the Republic of Korea. Specifically, we evaluated the controls over the Labor Cost Sharing and Host Nation Funded Construction programs.

## What We Found

Controls over the programs we evaluated were generally adequate and no material internal control weaknesses were identified. However, we identified three areas of concern:

- Burdensharing funds are not always being used as intended. Specifically, U.S. Forces Korea officials are using burdensharing funds to pay nonappropriated fund labor costs. Using burdensharing funds for this purpose does not result in a reduction of costs to the United States for the stationing of forces in Korea.
- The Labor Cost Sharing cashflow process is obscured by unnecessary steps. As a result, oversight officials cannot readily ensure that Labor Cost Sharing funds are used as intended.
- The monitoring of the internal controls for the Korean National pay process at the 51<sup>st</sup> Comptroller Squadron, U.S. Air Forces Korea is inadequate. As a result, officials cannot be assured that controls are in place and working effectively.

## What We Recommended

To ensure burdensharing funds are used as intended we recommended the following:

- Stop providing burdensharing funds to nonappropriated fund instrumentalities, recoup the burdensharing funds given to the Dragon Hill Lodge, and redistribute those funds to appropriated entities at U.S. Forces Korea.
- Establish clear guidance that simplifies the Labor Cost Sharing cashflow process by eliminating unnecessary steps.
- Improve the internal control program as it relates to the Korean National pay process by developing a written description of the controls in place and completing documented reviews to provide the basis for annual assurance statements.

## Client Comments and Our Response

The Acting Deputy Chief Financial Officer, responding for the Under Secretary of Defense (Comptroller)/Chief Financial Officer; Chief of Staff, U.S. Forces Korea, responding for the Commander, U.S. Forces Korea; and Commander, 7<sup>th</sup> Air Force, responding for the Commander, 51<sup>st</sup> Comptroller Squadron, concurred with all recommendations. However, the Chief of Staff, U.S. Forces Korea provided comments on finding B that required an additional recommendation. We request additional comments from the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Director, Defense Finance and Accounting Service, and Commander, U.S. Forces Korea by September 25, 2008. Please see the recommendations table on the back of this page.

## Recommendations Table

Client	Recommendations Requiring Comment	No Additional Comments Required
Under Secretary of Defense (Comptroller)/Chief Financial Officer	B.2.a., B.2.b.	A.1., A.2.
Commander, U.S. Forces Korea	B.2.a., B.2.b.	B.1.a., B.1.b., and B.1.c.
Commander, 51 <sup>st</sup> Comptroller Squadron, U.S. Air Forces Korea		C.1., C.2.
Director, Defense Finance and Accounting Service	B.2.a., B.2.b.	

**Please provide comments by September 25, 2008.**

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# Introduction

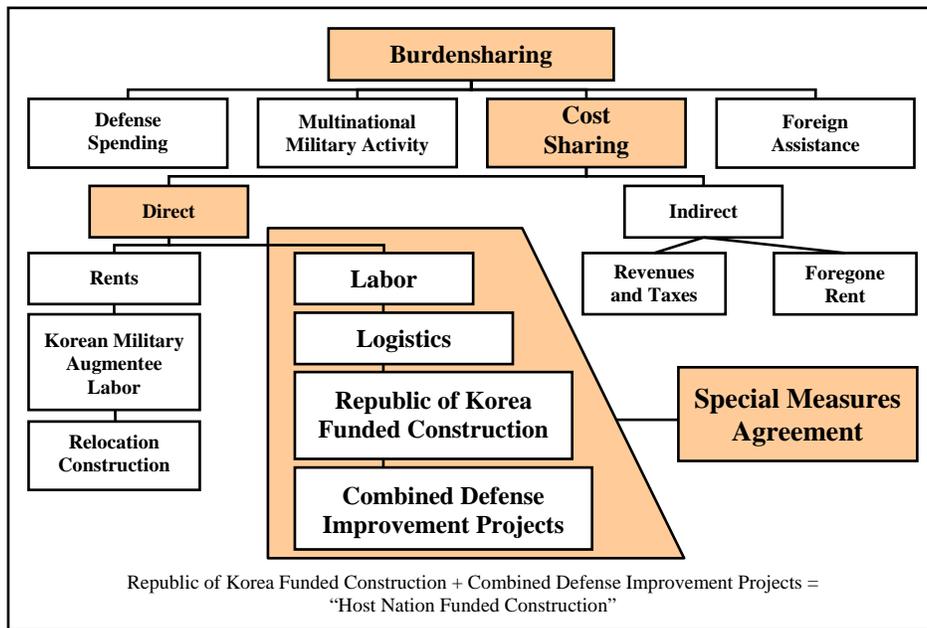
## Objectives

The Commander, U.S. Forces Korea (USFK), asked the DoD Office of Inspector General to evaluate the controls over Host Nation Support (HNS) in Korea. The objective of this audit was to evaluate the controls over HNS of U.S. Forces in Korea during armistice and hostilities. However, because of time constraints, we limited the scope of the audit to include only HNS during armistice. See Appendix A for a discussion of the scope and methodology and prior coverage related to the objective.

## Background

### ***Burdensharing and Cost Sharing***

The United States expects its allies to share in the responsibilities of supporting the common defense. Public Law 104-201, “National Defense Authorization Act for FY 1997,” September 23, 1996, section 1084, states that U.S. allies should provide burdensharing support in the following four areas: defense spending, multinational military activity, cost sharing, and foreign assistance. Figure 1 provides an overview of the use of the cost sharing contributions provided to USFK by the Republic of Korea (ROK).



Source: Derived from USFK Regulation 415-1

**Figure 1. USFK Cost Sharing Overview**

This audit focused on the controls and use of cash and in-kind<sup>1</sup> contributions provided by the ROK to USFK as outlined in the Special Measures Agreement.

Cost sharing includes cash and in-kind contributions provided by a host nation in support of U.S. Forces stationed in the contributing country. Section 2350j, title 10, United States Code (10 U.S.C. 2350j) authorizes the Secretary of Defense to accept contributions from any country or regional organization for the following DoD expenditures: compensation for local national employees, military construction, and supplies and services.

### ***Special Measures Agreement and Implementation Arrangement***

The Special Measures Agreement states that the ROK is to bear a part of the costs associated with stationing U.S. Forces in Korea. Those costs include Labor Cost Sharing (LCS); Host Nation Funded Construction, which is a combination of ROK Funded Construction and Combined Defense Improvement Projects; and Logistics Cost Sharing.

The agreement is renegotiated every 2 years, and the current agreement covers 2007 and 2008. The ROK contributed ₩725.5 billion<sup>2</sup> in 2007 and ₩741.5 billion in 2008. The 2008 amount was determined by increasing the 2007 contribution by the December 2006 consumer price index of 2.2 percent.

The 2007-2008 “Implementation Arrangement,” April 4, 2007, provides specific guidance on the allocation and use of the contributed funds. The arrangement states that, “after consultation with the ROK Ministry of National Defense, USFK shall provide the Ministry of National Defense with the allocations for each cost sharing category.” The allocations in 2007 included ₩295.4 billion for LCS, ₩297.5 billion for Host Nation Funded Construction, and ₩132.5 billion for Logistics Cost Sharing. The Implementation Arrangement provides guidance for the use of these funds as follows.

- Contributions for LCS are to be paid in cash. Contributions provided by the ROK are to be used solely to pay the salaries and benefits for Korean National (KN) employees. The total amount of the contributions from the ROK are to be no more than 71 percent of the labor costs for the USFK Korean workforce. The 2007 contribution was approximately 66 percent of the total appropriated Korean labor cost.
- The Logistics Cost Sharing program is an in-kind program. USFK officials order supplies and services from contracts negotiated by USFK and awarded by the ROK Ministry of National Defense and forward all certified invoices to the Ministry of National Defense for payment. We did not review the Logistics Cost Sharing

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<sup>1</sup> In-kind contributions are provided by the host nation but are not paid in cash. Contributions include equipment, supplies, or services.

<sup>2</sup> The ROK makes its contributions in Korean currency, Won (₩).

program because the Army Audit Agency reviewed the program, as reported in A-2005-0093-FFP, "Logistics Cost Sharing Program," January 12, 2005.

- The Host Nation Funded Construction program includes Combined Defense Improvement Projects and ROK Funded Construction. The Combined Defense Improvement Project program is primarily in-kind, meaning that the ROK contracts and pays for the construction of facilities for use by USFK. The ROK Funded Construction program is both a cash and in-kind program, where in-kind constitutes 10 percent or more of the contributions provided by the ROK.



## A. Use of Burdensharing Funds

Burdensharing funds are not always being used as intended. Specifically, USFK officials used ₩1 billion (approximately \$1 million) of the burdensharing funds contributed by the ROK to pay nonappropriated fund (NAF) labor costs. Using burdensharing funds to pay NAF labor costs does not result in a reduction of costs to the United States for the stationing of forces in Korea. USFK officials should stop distributing burdensharing funds to pay for NAF labor costs and recoup funds already distributed to NAF instrumentalities.<sup>3</sup>

### Timeline of Actions to Date

On January 19, 2007, the USFK, Judge Advocate General issued an opinion on the “Use of Burden Sharing Contributions for Dragon Hill Lodge Labor Costs.” The opinion stated that although the use of burdensharing funds for NAF costs was not expressly prohibited, such a change would require negotiation with the ROK. The opinion also stated that the intent of Congress was to use burdensharing funds to offset appropriations, and there is no provision that expressly authorizes the use of burdensharing funds to defray NAF costs. The opinion noted that using burdensharing funds to pay NAF costs would reduce the amount of funds available for other uses as the ROK has capped its total contributions. See Appendix B for the USFK, Judge Advocate General’s opinion.

On February 1, 2008, we issued a Quick-Reaction Report on the “Use of Republic of Korea Burdensharing Contributions for Labor Costs at the Dragon Hill Lodge” and recommended that USFK officials not use burdensharing funds to pay for NAF costs. See Appendix B for the Quick-Reaction Report.

On March 31, 2008, USFK officials responded to our report and nonconcurred with our recommendation. See Appendix C for the official response. The response included the following three points.

- The Commander, USFK, did not agree with the USFK, Judge Advocate General’s opinion that Congress intends for burdensharing funds to be used to offset appropriated fund costs.
- The 2007-2008 Implementation Arrangement authorizes the use of host nation funds to pay salaries and benefits of KN employees and does not specifically prohibit NAF KN employees.
- A restriction on the use of appropriated funds to offset self-sustaining entities does not clearly apply to the use of burdensharing funds.

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<sup>3</sup> A NAF instrumentality is a DoD organizational and fiscal entity supported in whole or in part by NAFs.

On April 14, 2008, USFK officials provided approximately \$1 million in burdensharing funds to pay NAF KN labor costs at the Dragon Hill Lodge.

## **Burdensharing Guidance**

Burdensharing funds are governed by 10 U.S.C. 2350j, which authorizes the acceptance of cash contributions to pay costs for local national employees of the DoD. Public Law 104-201, “National Defense Authorization Act for FY 1997,” September 23, 1996, section 1084, states that allies need to increase burdensharing contributions and that those funds are to be applied toward nonpersonnel stationing costs<sup>4</sup> incurred by the U.S. Government for stationing U.S. military personnel in their nation. DoD Financial Management Regulation, Volume 12, Chapter 24, “Burdensharing and Overseas Relocation Contributions by Foreign Allies,” December 2001, re-establishes burdensharing policy and assigns the Office of the Under Secretary of Defense (Comptroller)/Chief Financial Officer as the departmental point of contact for all matters involving the acceptance, receipt, administration, and distribution of burdensharing funds.

In addition, the Office of Management and Budget Circular No. A-123, “Management’s Responsibility for Internal Control,” December 21, 2004, states:

Management has a fundamental responsibility to develop and maintain effective internal control. The proper stewardship of Federal resources is an essential responsibility of agency managers and staff. Federal employees must ensure that Federal programs operate and Federal resources are used efficiently and effectively to achieve desired objectives. Programs must operate and resources must be used consistent with agency missions, in compliance with laws and regulations, and with minimal potential for waste, fraud, and mismanagement.

Further, USFK Regulation 37-2, “Republic of Korea Labor Cost Sharing Program,” April 29, 2004, discusses the proper use of burdensharing funds from the ROK applied to the LCS program. The regulation places restrictions on the types of organizations that may receive burdensharing funds for labor, and specifically excludes NAF entities from the LCS program.

## **Applying Burdensharing Funds to NAF Costs**

On April 14, 2008, USFK officials diverted approximately \$1 million from offsetting appropriated fund costs to pay for NAF KN labor costs at the Dragon Hill Lodge. The Chief of Staff, USFK, in response to our Quick-Reaction Report, stated that restrictions on the use of appropriated funds for NAF expenditures do not clearly apply to burdensharing funds. However, by applying the burdensharing funds to NAF costs,

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<sup>4</sup> Nonpersonnel stationing costs are expenses incurred while stationing U.S. Forces in the host nation, excluding military personnel pay and allowances. They are used to compute the percentage of the ROK cost sharing contribution, and consist of Operations and Maintenance, Family Housing Operations, and Military Construction.

USFK must then use appropriated funds to pay costs that would normally be offset by the burdensharing funds.

There are circumstances where it would be appropriate to use burdensharing or appropriated funds to pay NAF costs; for example, if special security conditions exist that adversely affected the ability of the instrumentality to generate revenues. However, USFK officials did not provide any indication that those circumstances exist at the Dragon Hill Lodge. The Dragon Hill Lodge is a Category C, NAF instrumentality<sup>5</sup> and is self-sustaining, as evidenced by its FYs 2005 through 2007 income, shown in Table 1.

**Table 1. Dragon Hill Lodge Income**

<b>Fiscal Year</b>	<b>Total Revenue (millions)</b>	<b>Net Income Before Depreciation (millions)</b>
2007	\$45.9	\$21.9
2006	43.8	19.7
2005	40.7	16.5
<b>Total</b>	<b>\$130.4</b>	<b>\$58.1</b>

## **Intent of Burdensharing Funds**

### ***Congressional Intent***

USFK officials are not using burdensharing contributions as intended by Congress. USFK diverted some ROK contributions to pay for NAF costs. Congress intended that burdensharing funds received from allies be used for the payment of nonpersonnel stationing costs and in lieu of appropriated funds. According to the USFK, Judge Advocate General's opinion:

These contributions have traditionally been viewed as off sets or replacements for the appropriations from Congress necessary to maintain forces overseas. The original version of the statute authorizing the acceptance of contributions (Sec. 1045 of the National Defense Authorization Act for Fiscal Years 1992 and 1993) states that burden sharing funds shall be credited to appropriations of the DoD and merged with the appropriations to which they are credited. While the statute has been amended several times and this early language is missing, we have found no indication that this original intent for the use of burden sharing funds has changed.

Although the Commander, USFK did not agree with the USFK, Judge Advocate General's opinion, he should not divert burdensharing funds to pay NAF costs unless there is a compelling reason to divert the funds and the ROK agrees. In addition, he

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<sup>5</sup> A Category C NAF instrumentality has the highest capability to generate revenue and therefore is expected to be self-sustaining.

should ensure proper stewardship of these limited funds by using them to offset nonpersonnel stationing costs because it ultimately results in a reduced burden on the U.S. taxpayer.

### ***USFK Understanding of Intent***

USFK officials have demonstrated their understanding of the intended use of burdensharing funds to offset nonpersonnel stationing costs, as shown by the following.

- USFK Regulation 37-2 states that there should be no net gain to the unit's budget because the burdensharing funds should offset the KN pay budget appropriated by Congress. As such, the burdensharing funds should reduce the unit's appropriated budget requirements and subsequently reduce the U.S. Government's overall budget requirements.
- USFK provides the ROK an annual LCS report showing the ROK's annual contribution as a percentage of the total KN labor costs. The total USFK KN labor costs do not include NAF employees.
- On April 24, 2007, the Commander, USFK, testified before the Senate Armed Services Committee and stated that the 2007 contributions from the ROK represented only 41 percent of nonpersonnel stationing costs, which was short of the equitable cost sharing goal. The Commander further stated that as a result of burdensharing shortfalls, USFK is forced to stretch limited funding.
- On March 11, 2008, the Commander, USFK, again testified before the Senate Armed Services Committee and stated that the ROK "pays about a third of our operations and maintenance costs. We call it bureaucratically nonpersonnel stationing costs."

### **Conclusion**

Burdensharing funds should be used to offset nonpersonnel stationing costs. However, USFK officials diverted burdensharing funds to pay NAF costs at the Dragon Hill Lodge, which had a net profit of \$22 million in 2007. Applying burdensharing funds to NAF costs does not meet the intent of Congress or USFK, because it does not reduce nonpersonnel stationing costs or the burden on the U.S. taxpayer. In addition, applying limited burdensharing funds to an already profitable organization is not an efficient or effective use of approximately \$1 million of government funds.

## **Recommendations, Client Comments, and Our Response**

**A. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer:**

- 1. Require U.S. Forces Korea officials to stop using Republic of Korea burdensharing funds to pay nonappropriated fund costs without justification and without the consent of the Republic of Korea.**
- 2. Recoup the burdensharing funds already distributed to the Dragon Hill Lodge, and redistribute them to pay the U.S. Forces Korea appropriated fund Korean National labor costs.**

**Under Secretary of Defense (Comptroller)/Chief Financial Officer Comments.** The Acting Deputy Chief Financial Officer, responding for the Under Secretary of Defense (Comptroller)/Chief Financial Officer (the Under Secretary), concurred with recommendations A.1. and A.2. The Acting Deputy Chief Financial Officer stated that a memorandum was in coordination for the Under Secretary's signature directing USFK to terminate the use of burdensharing funds to offset KN NAF personnel costs and to recoup the burdensharing funds already distributed to the Dragon Hill Lodge and use them to offset appropriated fund costs. The estimated completion date for this memorandum was July 30, 2008; however, through follow-up efforts, we determined that the Under Secretary issued this memorandum to the Commander, USFK on July 7, 2008.

**Our Response.** The comments were fully responsive, and no additional comments are required.



## **B. Labor Cost Sharing Cashflow Process**

USFK officials have established and implemented controls to process, document, and account for the use of LCS funds. Although we did not find any material control weaknesses, we did identify some unnecessary steps that obscure the LCS cashflow process. As a result, oversight officials cannot readily ensure that LCS funds are used as intended. USFK officials should improve the LCS cashflow process by:

- depositing all LCS funds contributed by the ROK into one account,
- disbursing all of the contributed funds in Won (preferably by electronic funds transfer) from the specified account, and
- maintaining all of the contributed funds in the specified account until fully disbursed.

### **Overview of the LCS Cashflow Process**

The 175<sup>th</sup> Financial Management Center (FMC) is responsible for coordinating the receipt and distribution of LCS funds for USFK. The 175<sup>th</sup> FMC receives these funds from the ROK annually in three payments (April, June, and August) and distributes them to participating organizations upon receipt. In 2007, there were 27 organizations that received LCS funds. The method of distribution depends on how the 175<sup>th</sup> FMC officials categorize the organizations. The categories and methods of distribution for the 2007 payments were as follows.

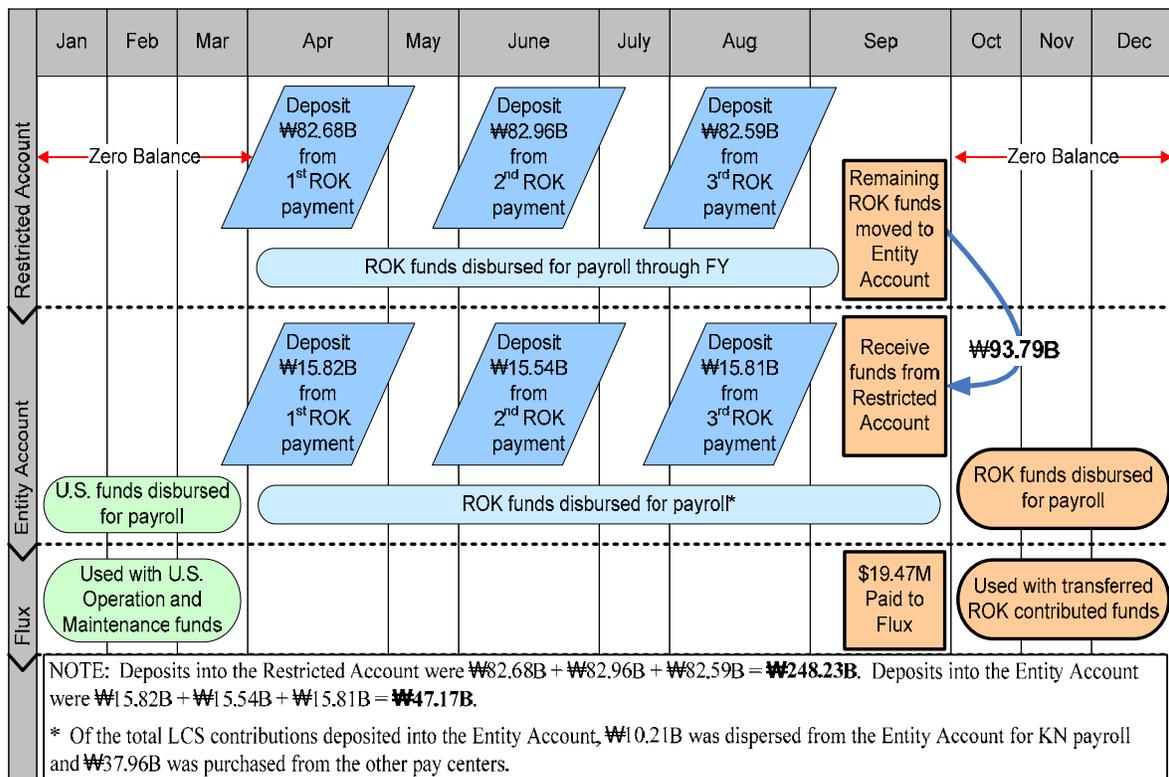
- Organizations that managed their own pay centers – The 175<sup>th</sup> FMC officials distributed cash payments to two pay centers, U.S. Air Forces Korea and U.S. Naval Forces Korea. The Air Force and Navy then paid their KN employees.
- Organizations that managed their own payroll accounts – The 175<sup>th</sup> FMC officials distributed cash payments or vouchers to seven organizations (see Table 2 on page 12, organizations 3-9). These organizations credited their own appropriations upon receipt of funds; however, the 175<sup>th</sup> FMC paid their KN employees and charged the appropriate accounts for each payment.
- Organizations that had their payroll accounts managed by the 175<sup>th</sup> FMC – The 175<sup>th</sup> FMC officials credited the other 18 organizations' appropriations upon receipt of LCS funds and charged the appropriate accounts when making payroll payments.

Officials from the 175<sup>th</sup> FMC receive and distribute LCS contributions from the ROK using two Won-based bank accounts: the Restricted Account and the Entity Account. The Restricted Account is only used to maintain and disburse LCS contributions from the ROK. The Entity Account is primarily used to maintain funds for other USFK

obligations that require payments in Won, such as Korean vendors and contractors; however, it is also used to maintain and disburse some LCS contributions from the ROK.

Most of the Won maintained in the Entity Account is converted from dollars, which requires the use of the Foreign Currency Fluctuation Account (Flux Account).<sup>6</sup> Therefore, when any disbursement is made from the Entity Account, the difference between the budget rate<sup>7</sup> and the current exchange rate is charged directly to the Flux Account.

Conversely, all the Won maintained in the Restricted Account is contributed directly from the ROK and not converted from dollars; therefore, the Flux Account is not needed. Figure 2 describes the LCS cashflow process, which will be explained in the paragraphs that follow.



**Figure 2. LCS Cashflow Process (Using 2007 Amounts)**

<sup>6</sup> The Foreign Currency Fluctuation Account is used to alleviate the adverse effect of fluctuations in exchange rates on DoD programs funded by Operation and Maintenance appropriations.

<sup>7</sup> The budget rate is a foreign currency exchange rate provided by the DoD Comptroller to DoD Components for preparing budget submissions during budget formulation and for recording obligations during budget execution.

## Depositing Contributions From the ROK

Officials from the 175<sup>th</sup> FMC unnecessarily deposit LCS contributions from the ROK into two accounts. For 2007, as shown in Figure 2, they deposited approximately ₩248 billion into the Restricted Account over three payments and approximately ₩47 billion into the Entity Account over three payments. The LCS deposits into the Entity Account represent the LCS portions for the additional two pay centers and the seven organizations that manage their own accounts.

Depositing contributions from the ROK into the Entity Account is confusing and unnecessary. Additionally, commingling these funds with funds used to pay other obligations can give the appearance that LCS contributions from the ROK are not being used as intended. Simplifying the process by depositing all LCS contributions from the ROK into the Restricted Account would more clearly show that funds are used as intended.

## Disbursing Contributions From the ROK

Officials from the 175<sup>th</sup> FMC unnecessarily paid some organizations their LCS portions in dollars. The payments in dollars are shown in Table 2 and were equivalent to the ₩47 billion deposited into the Entity Account.

**Table 2. Organizations That Received Their LCS Portions in U.S. Dollars**

Organization	2007 LCS Portions		Method of Transfer
	Dollar Equivalent Transferred (millions)	Won Deposited Into Entity (billions)	
1. U.S. Air Forces Korea*	\$35.23	₩32.67	Treasury checks
2. U.S. Naval Forces Korea*	4.63	4.29	Treasury checks
3. DoD Dependent Schools	1.02	0.95	IPAC**
4. Defense Commissary Agency	7.76	7.20	IPAC**
5. Defense Contract Audit Agency	0.04	0.03	Treasury checks
6. Criminal Investigation Division	0.84	0.78	Treasury checks
7. Defense Intelligence Agency	0.44	0.41	Treasury checks
8. Defense Logistics Agency	0.33	0.30	Vouchers
9. Special U.S. Liaison Activity Korea	0.58	0.54	Vouchers
<b>Total</b>	<b>\$50.87</b>	<b>₩47.17</b>	

\* Manage own pay centers  
 \*\* Intragovernmental Payment and Collection System, an automated intragovernmental system operated by the Department of the Treasury and used for billing services and supplies.

Officials from the 175<sup>th</sup> FMC transferred dollars to the nine organizations in Table 2 because the organizations manage either their own pay centers or payroll accounts. However, disbursing contributions from the ROK in dollars to any of the organizations is complicated and unnecessary. For example, the pay centers that receive Treasury checks must convert the U.S. dollars to Won to pay their KN employees. Additionally, the 175<sup>th</sup>

FMC officials make payroll disbursements for the other seven organizations and charge the appropriate organizational accounting code; thus, there is no need for an actual transfer of funds. To simplify the process, 175<sup>th</sup> FMC officials should disburse the LCS portions to other pay centers in Won via electronic funds transfer from the Restricted Account and credit the accounts of organizations for which the 175<sup>th</sup> FMC is the pay center.

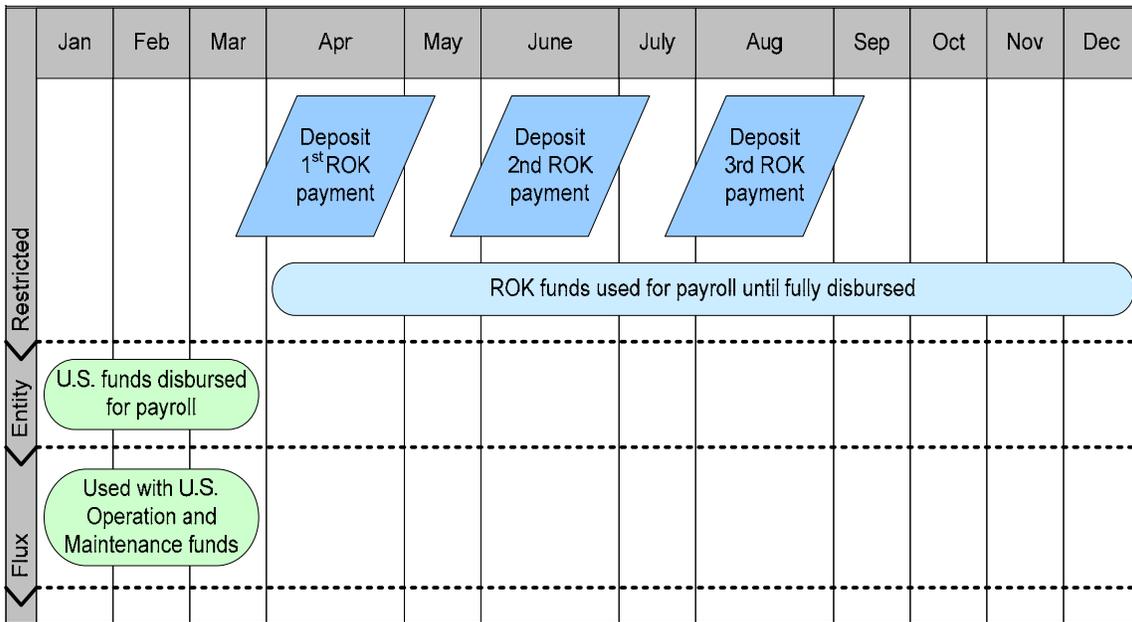
## **Maintaining Contributions From the ROK**

Officials from the 175<sup>th</sup> FMC unnecessarily transfer LCS funds from the Restricted Account to the Entity Account at the close of the fiscal year. As shown in Figure 2, in September 2007, the amount transferred was approximately ₩93.79 billion. Officials from the 175<sup>th</sup> FMC stated that they zero out the Restricted Account because the budget rate changes every fiscal year. However, the location of the cash does not need to affect how they account for disbursements. Moving these funds is not only unnecessary but also commingles LCS funds with funds used to pay other obligations (such as Korean vendors and contractors) and may give the appearance that funds contributed by the ROK are not being used as intended.

Additionally, the transfer causes the 175<sup>th</sup> FMC to pay into the Flux Account, which is another unnecessary step. As previously stated, the 175<sup>th</sup> FMC uses the Flux Account when making payments from the Entity Account, but does not use it for payments from the Restricted Account. Therefore, 175<sup>th</sup> FMC officials make a payment to the Flux Account to compensate for the use of it with the transferred funds contributed by the ROK. As shown in Figure 2, in 2007, the amount paid to the Flux Account was approximately \$19.47 million, which equaled the difference between the budget and current exchange rate of the funds transferred to the Entity Account. The 175<sup>th</sup> FMC could avoid this unnecessary step by maintaining ROK contributed funds in the Restricted Account until fully disbursed.

## **Conclusion**

Unnecessary steps obscure the LCS cashflow process. Eliminating these unnecessary steps will better enable oversight officials to ensure that LCS funds are being used as intended. Figure 3 shows the recommended, streamlined LCS process to ensure accountability over the use of these funds. As the figure shows, all LCS contributions from the ROK are to be deposited into the Restricted Account, where they remain until disbursed for payroll or to other pay centers. Additionally, the Entity Account is only to be used to pay the U.S. portion of KN labor.



**Figure 3. Recommended LCS Cashflow Process**

## Actions to Date

USFK Resource Management officials have been working with the 175th FMC to simplify the process. For the first payment of 2008, 175<sup>th</sup> FMC officials disbursed funds to other pay centers via electronic funds transfer instead of the previous method, which was a Treasury check.

## Client Comments on the Finding and Our Response

In the USFK response to the draft report, the Chief of Staff, USFK stated that USFK had instituted a series of process changes and improvements, to include issuing interim guidance to all three servicing KN payroll activities in USFK (175<sup>th</sup> FMC, 7<sup>th</sup> Air Force, and Naval Forces Korea) to meet the intent of the recommendations. The Chief of Staff also stated that USFK would continue to work with all stakeholders to fully implement a long-term practical solution.

The Chief of Staff noted that a “one size fits all” solution to these process changes was not practical because of differences in Defense Finance and Accounting Service and Service systems, and varying accounting and disbursing practices. As a result, he requested that we facilitate policy reviews with officials at the DoD Comptroller and Defense Finance and Accounting Service to address differences in accounting and disbursing procedures for LCS funds, including:

- establishing consistent USFK guidance on the exchange rate to use when collecting and maintaining ROK contributed funds;
- using the Foreign Currency Fluctuation Account for funds contributed in Korean currency;

- updating software of disbursing systems to avoid use of the Foreign Currency Fluctuation Account;
- obtaining an exception to DoD policy for how much cash on-hand a disbursing officer can have; and
- obtaining clear guidance from the Defense Finance and Accounting Service for how funds should be posted to the end user's account.

We agree that officials at the DoD Comptroller and Defense Finance and Accounting Service should coordinate with USFK and the payroll activities (175<sup>th</sup> FMC, 7<sup>th</sup> Air Force, and Naval Forces Korea) to address the stated concerns and, as such, we contacted both offices to facilitate action.

As a result of the comments provided by the Chief of Staff, USFK, we added a recommendation for the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Director, Defense Finance and Accounting Service and the Commander, U.S. Forces Korea to conduct joint reviews of accounting and disbursing procedures to resolve the policy and procedural issues (see Recommendation B.2.a.). Also, as a result of the client comments, draft finding B and Recommendations 1., 2., and 3. have been renumbered as finding B.1. and Recommendations a., b., and c.

## **Recommendations, Client Comments, and Our Response**

**B. We recommend that the Commander, U.S. Forces Korea, establish clear guidance to eliminate unnecessary steps and simplify the Labor Cost Sharing cashflow process.**

- 1. At a minimum, the Commander, U.S. Forces Korea, should require:**
  - a. All Labor Cost Sharing funds contributed by the Republic of Korea to be deposited into the Restricted Account.**
  - b. All disbursements of Labor Cost Sharing funds contributed by the Republic of Korea to be made in Won from the Restricted Account (preferably by electronic funds transfer).**
  - c. All Labor Cost Sharing funds contributed by the Republic of Korea to remain in the Restricted Account until fully disbursed.**

**Commander, U.S. Forces Korea Comments.** The Chief of Staff, USFK, responding for the Commander, USFK, concurred with Recommendations B.1.a., B.1.b., and B.1.c. The Chief of Staff stated that for Recommendation B.1.a., all three servicing payroll activities were directed to establish a Won denominated restricted account to receive, hold, and disburse Won received from the ROK government solely for the purpose of KN payroll. The Chief of Staff also stated that USFK officials held discussions with the ROK Ministry of National Defense, and they agreed to deposit Won payments directly into three restricted accounts. For Recommendation B.1.b., the Chief of Staff stated that all

three servicing organizations have established restricted Won accounts, and the ROK government is depositing Won directly into these accounts via electronic funds transfer. For Recommendation B.1.c., the Chief of Staff agreed that all LCS funds contributed by the ROK should be maintained in the restricted account until fully disbursed.

**Our Response.** The comments were fully responsive, and no additional comments are required.

- 2. We recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Director, Defense Finance and Accounting Service, and the Commander, U.S. Forces Korea, conduct joint reviews of accounting and disbursing policy.**
  - a. At a minimum, the policy reviews should address the following topics:**
    - **exchange rate for collecting and maintaining Republic of Korea contributed funds,**
    - **Foreign Currency Fluctuation Account usage,**
    - **software updates to disbursing systems,**
    - **disbursing officers' cash on hand, and**
    - **treatment of funds posted to end user's account.**
  - b. Based on the results of the joint reviews conducted under Recommendation B.2.a., we recommend that the Under Secretary of Defense (Comptroller)/Chief Financial Officer, the Director, Defense Finance and Accounting Service, and the Commander, U.S. Forces Korea, develop and implement guidance as necessary.**



## **C. Monitoring Air Force Controls Over the Pay Process for Korean Labor**

The 51<sup>st</sup> Comptroller Squadron, U.S. Air Forces Korea needs to improve its internal control program for the KN pay process. Although we found pay controls to be adequate, officials need to strengthen their monitoring of the controls. Without an adequate monitoring process, there is no assurance that controls are in place and working effectively for the \$45 million in payroll disbursed annually to the KN employees. The 51<sup>st</sup> Comptroller Squadron officials should develop a written description of the controls in place and evaluate those controls annually.

### **Pay Overview of the KN Employees**

The 51<sup>st</sup> Comptroller Squadron is responsible for processing all pay costs for KN employees of U.S. Air Forces Korea. The KN pay section, which is a part of the civilian pay section at the 51<sup>st</sup> Comptroller Squadron, reviews timesheets and prepares disbursement vouchers for payments to Koreans for salaries and other pay-related costs, such as taxes and insurance. The KN pay section is unique to the 51<sup>st</sup> Comptroller Squadron because it is responsible for processing and disbursing funds to pay the Korean civilians they employ. For all other Air Force civilians, the Defense Finance and Accounting Service processes their payroll.

According to DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” January 4, 2006, managers must identify, correct, and establish internal controls and establish a program to review, assess, and report on the effectiveness of internal controls. Each DoD Component is to develop an internal control program and segment it into organizational assessable units. An assessable unit is defined as an organizational subdivision that requires compliance with the internal control program. Monitoring the effectiveness of internal controls should occur in the normal course of business through periodic assessments.

Also, Air Force Instruction 65-201, “Managers’ Internal Control Program Procedures,” October 12, 2006, states that managers are responsible for continuously monitoring their internal controls. Managers must evaluate and develop a written description of their internal controls so excessive controls can be eliminated and weak controls can be improved. The evaluation is a documented review of an assessable unit to determine whether internal controls exist and are effectively implemented.

### **Monitoring and Evaluating Controls**

The 51<sup>st</sup> Comptroller Squadron’s internal control program, as it relates to monitoring the KN pay process, is inadequate. Air Force officials use a standard Air Force quality assurance checklist to evaluate the civilian pay process. However, the checklist does not identify or evaluate internal controls for the unique KN pay section at the 51<sup>st</sup> Comptroller Squadron. We reviewed those internal controls and found them to be generally adequate; however, 51<sup>st</sup> Comptroller Squadron officials were unable to provide

a documented review of the controls. The 51<sup>st</sup> Comptroller Squadron needs to develop an evaluation process that adequately reviews the internal controls for the \$45 million in KN payroll disbursed annually. See Appendix D for our methodology for reviewing the internal controls.

## **Actions to Date**

During our audit, the 51<sup>st</sup> Comptroller Squadron officials initiated actions to improve their evaluation of internal controls for the pay process for KN employees. They developed an outline of the pay process and drafted a checklist to evaluate the internal controls within that process.

## **Recommendations, Client Comments, and Our Response**

**C. We recommend that the Commander, 51<sup>st</sup> Comptroller Squadron, U.S. Air Forces Korea improve the internal control program as it relates to the pay process for Korean National employees. At a minimum, the Commander should:**

- 1. Develop a written description of the controls in place over the Korean National pay section.**
- 2. Complete documented reviews of the internal control process to provide the basis for annual assessments of the pay process for Korean National employees.**

**Commander, 51<sup>st</sup> Comptroller Squadron Comments.** The Commander, 7<sup>th</sup> Air Force, responding for the Commander, 51<sup>st</sup> Comptroller Squadron, concurred with Recommendations C.1. and C.2. The Commander, 7<sup>th</sup> Air Force stated that for Recommendation C.1., an alternate management control checklist providing internal controls specifically targeted to manage LCS funds was developed to document the control process. For Recommendation C.2., the Commander, 7<sup>th</sup> Air Force stated that the alternate management control checklist was developed in coordination with the USFK staff and serves the dual purpose of (a) documenting their control processes, and (b) validating recurring reviews to ensure effective implementation. The Commander, 7<sup>th</sup> Air Force stated that the checklist was completed May 21, 2008, and would be executed on a quarterly basis.

**Our Response.** The comments were fully responsive, and no additional comments are required.

## **Appendix A. Scope and Methodology**

We conducted this performance audit from August 2007 through April 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

To accomplish the audit objective, we reviewed applicable laws, policies, agreements, instructions, and other guidance. We interviewed Service Component, Defense Finance and Accounting Service, and USFK officials responsible for the following areas as they relate to HNS: policy, oversight, funding and accounting processes, labor, construction, logistics, and Wartime HNS. Because of time constraints, we limited the scope of the audit work by excluding Wartime HNS.

We focused on direct cost sharing support provided by the ROK; specifically, the support outlined in the Special Measures Agreement. We evaluated the controls over the LCS and Host Nation Funded Construction programs. We did not review the Logistics Cost Sharing program because the Army Audit Agency reviewed the program, as reported in A-2005-0093-FFP, "Logistics Cost Sharing Program," January 12, 2005. See Prior Coverage.

To evaluate the controls over the LCS program, we reviewed calendar year and FY 2007 budget and accounting documentation, assessed the cashflow process, verified the certification and accreditation of the KN pay systems, reviewed the access controls over the KN pay systems, and verified a statistical sample of KN employees against personnel records. See Appendix D for a detailed discussion of the controls we observed.

To evaluate the controls over the Host Nation Funded Construction program, we verified a judgmental sample of projects in the construction phase; interviewed resident engineers; reviewed project documentation; and reviewed the process for receipt, maintenance, and distribution of the program funds. See Appendix E for a detailed discussion of the controls we observed.

### **Review of Internal Controls**

We reviewed the adequacy of internal controls as they applied to our audit objective. We did not identify any material internal control weaknesses; however, we identified areas where USFK could strengthen its oversight, as detailed in findings B and C. Implementing the recommendations in the report will improve the quality of oversight.

### **Use of Computer-Processed Data**

We relied on computer-processed data generated by two computer systems. We pulled data from the International Civilian Pay System, Version 1.0, and the 175<sup>th</sup> FMC

Network KN Payroll System. These data were used during the verification of KN employees within USFK.

The DoD Office of Inspector General, Technical Assessment Directorate evaluated the appropriate documentation from each system to determine if the systems were in compliance with the DoD Information Technology Security Certification and Accreditation Process. The Technical Assessment Directorate determined that the KN Payroll System had a current authority to operate, but the International Civilian Pay System only had an interim authority to operate. However, the Directorate determined that the interim authority to operate was appropriately issued with a plan of action and milestones for completing the certification and accreditation process. Therefore, the Directorate concluded that the general controls were in place for each system and the data obtained were reliable. See Appendix D for the detailed methodology of our statistical sample and certification and accreditation verification.

## **Use of Technical Assistance**

The DoD Office of the Inspector General, Quantitative Methods Directorate developed a statistical sample of KN employees. See Appendix D for the detailed methodology of our statistical sample.

## **Prior Coverage**

During the last 5 years, the Army Audit Agency issued four reports discussing HNS of U.S. Forces in Korea. Unrestricted Army Audit Agency audit reports can be accessed on the Internet at <https://www.aaa.army.mil>.

### ***Army***

Army Audit Agency Report No. A-2007-0167-FFP, “Followup Audit of Logistics Cost Sharing Program,” July 23, 2007

Army Audit Agency Report No. A-2007-0035-FFP, “Logistics Support Contract – Maintenance of High Mobility Multipurpose Wheeled Vehicles and Heavy Expanded Mobility Tactical Trucks,” January 10, 2007

Army Audit Agency Report No. A-2006-0133-FFP, “Corps of Engineers Contracting,” June 7, 2006

Army Audit Agency Report No. A-2005-0093-FFP, “Logistics Cost Sharing Program,” January 12, 2005

# Appendix B. Quick-Reaction Report



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-4704

February 1, 2008

MEMORANDUM FOR COMMANDER, U.S. FORCES KOREA

SUBJECT: Use of Republic of Korea Burdensharing Contributions for Labor Costs at the Dragon Hill Lodge

**Executive Summary.** We conducted fieldwork on the audit of Host Nation Support of U.S. Forces in Korea from October through December 2007. During the audit, we determined that USFK officials are considering using a portion of annual burdensharing funds, provided by the Republic of Korea (RoK) Government, to pay Korean labor costs at the Dragon Hill Lodge (DHL) – a Category C, nonappropriated fund instrumentality. Annual burdensharing funds are used to support costs funded through appropriations; however, the DHL does not receive appropriated funds. In FY 2007, the DHL reported a net profit of approximately \$15 million. We recommend that USFK officials not use burdensharing funds to pay for nonappropriated fund costs. Therefore, we are providing this quick-reaction report, requested by USFK officials, to address the subject matter. A complete audit report will be issued at a later date.

## Labor Cost Sharing

**USFK Judge Advocate General.** The USFK Judge Advocate General addressed the subject issue in his memorandum, "Use of Burdensharing Contributions for DHL Labor Costs," January 19, 2007 (Attachment 1). The memorandum explains that the DHL is a nonappropriated fund instrumentality that is expected to be self-sustaining. The memorandum also explains that although the wording in section 2350j, title 10, United States Code (10 U.S.C. 2350j) has changed throughout the years, there is no indication that the intent of Congress – to allow burdensharing funds to be used in lieu of appropriated funds, which are necessary to maintain forces overseas – has changed.

**Dragon Hill Lodge.** The DHL is a Category C, nonappropriated fund instrumentality. As such, it is expected to be self-sustaining. In certain circumstances, a Category C instrumentality can receive appropriated fund support – for example, if special security conditions exist that adversely affect the ability of the instrumentality to generate revenues. Currently, such conditions do not appear to exist at the DHL. The DHL does provide official lodging support to DoD employees by renting rooms to personnel on temporary duty and permanent change of station orders. However, this service is not provided at a reduced rate; in fact, these two categories are the two highest rates charged by the DHL, which reported a net profit of approximately \$15 million for FY 2007. Using burdensharing funds to pay expenditures at this nonappropriated fund instrumentality would only support an already

profitable entity at a cost to the U.S. taxpayer. In addition, according to the USFK Judge Advocate General, such a decision would be in conflict with the intent of 10 U.S.C. 2350j.

**Recommendation.** We recommend that USFK officials not use burdensharing funds to pay for nonappropriated fund costs. We request that the Commander, USFK send official, signed comments to this quick-reaction report by March 3, 2008.



Paul J. Granetto  
Principal Assistant Inspector General  
for Auditing

# USFK Judge Advocate General Opinion (Attachment 1 to Quick-Reaction Report)



HEADQUARTERS, UNITED STATES FORCES, KOREA  
UNIT # 15237  
APO AP 96205-0010

REPLY TO  
ATTENTION OF:

FKJA

19 January 2007

MEMORANDUM FOR Director, Installation Management Command-Korea

SUBJECT: Use of Burden Sharing Contributions for Dragon Hill Lodge Labor Costs

1. ISSUE: Can burden sharing contributions received from the Republic of Korea be used to pay labor costs for employees of the Dragon Hill Lodge Armed Forces Recreation Center?
2. BLUF. Use of burden sharing funds for NAF host nation employees is not expressly prohibited, but such a change in use requires negotiation with the RoK through the SMA Implementing Agreements and review by the Assistant Secretary of the Army (FM&C).
3. DISCUSSION: Burden sharing funds are governed by 10 USC §2350j, which allows the acceptance and use of contributions for the compensation to DoD local national employees, DoD military construction projects, and DoD supplies and services. These contributions have traditionally been viewed as "off sets" or replacements for the appropriations from Congress necessary to maintain forces overseas. The original version of the statute authorizing the acceptance of contributions (Sec. 1045 of the National Defense Authorization Act for Fiscal Years 1992 and 1993) states that burden sharing funds shall be credited to appropriations of the DoD and merged with the appropriations to which they are credited. While the statute has been amended several times and this early language is missing, we have found no indication that this original intent for the use of burden sharing funds has changed.
4. In Korea, Article V of the Status of Forces Agreement requires the United States to bear all costs for the maintenance of US armed forces in the RoK. By Special Measures Agreements commencing in 1991, the RoK has contributed to the costs of US forces through burden sharing funds and programs, including 71% of the labor costs for Korean national employees of the US. The specific procedures and programs are negotiated with the RoK and an Implementing Agreement is signed by USFK and the RoK Ministry of National Defense.

FKJA

SUBJECT: Use of Burden Sharing Contributions for Dragon Hill Lodge Labor Costs

5. It is unclear whether NAF employees have ever been included in the labor cost sharing portion of the SMA. We have found no provision which expressly authorizes the use of burden sharing funds to defray NAF employee costs. Because NAFs are intended to be self sustaining and NAF funds are not appropriated by Congress, the use of burden sharing funds for NAF employees would not result in any reduction of costs to the US for the stationing of forces in Korea. Further, their addition now would reduce the amount of burden sharing funds available for other uses since the RoKG has capped its total contribution to the US. In other words, any expansion of the pool of HN employees will decrease the funds available for RoK Funded Construction and Logistics Cost Sharing, to include SRM.

6. The DoD Financial Management Regulation Volume 12, Chapter 24, covers burden sharing contributions. Paragraph 240305 assigns responsibility for review and approval of the distribution of funds in Korea to the Assistant Secretary of the Army (FM&C). At a minimum, prior to using burden sharing funds for NAF labor costs, coordination with FM&C should be accomplished.

7. RECOMMENDATION: If the use of burden sharing contributions for NAF employees is desired, USFK should coordinate this change with FM&C and notify the RoKG through the SMA Implementing Agreement negotiations process.

  
STEVEN T. STRONG  
COL, US Army  
Judge Advocate

# Appendix C. U.S. Forces Korea Response to Quick-Reaction Report



HEADQUARTERS, UNITED STATES FORCES, KOREA

UNIT #15237  
APO AP 96205-5237

REPLY TO  
ATTENTION OF:

31 MAR 2008

FKCS-IR

MEMORANDUM FOR Inspector General, Department of Defense, 400 Army Navy Drive,  
Arlington, VA 22202-4704

SUBJECT: Response to DoDIG Quick-Reaction Report on the Use of Republic of Korea (ROK)  
Burdensharing Contributions for Labor Costs at the Dragon Hill Lodge

1. Commander, United States Forces Korea (USFK), does not concur with the DoDIG recommendation that USFK not use burdensharing funds to offset non-appropriated fund (NAF) Korean National labor costs at the Dragon Hill Lodge.

a. Commander, USFK, does not concur with the 19 Jan 07 opinion, referenced in the DoDIG report, that 10 USC §2350j establishes Congressional intent that host nation funds be used only as appropriated funds.

b. An international agreement, the U.S.-ROK Implementation Arrangement, establishes authority for the expenditure of host nation funds.

(1) The current arrangement, which governs host nation contributions in 2007 and 2008, authorizes the use of host nation funds to pay salaries and benefits of Korean National employees.

(2) The Implementation Arrangement does not prohibit the use of host nation funds to pay NAF Korean National employee salaries.

(3) Commander allocated host nation funding in the labor category is used solely to pay Korean National employee salaries and benefits in accordance with the Implementation Arrangement.

c. Restrictions on the use of appropriated funds to offset Category C NAF instrumentality costs do not clearly apply to the use of host nation funds.

2. USFK appreciates the Quick-Reaction Report provided by the DoDIG concerning this action and recognizes the accelerated effort of DoDIG team at the request of USFK to provide input to this matter.

3. POC is Mr. Young J. Jin at DSN (315) 723-3740, Email: jinyj@korea.army.mil.

FOR THE COMMANDER:

JOSEPH F. FIL, JR  
Lieutenant General, US Army  
Chief of Staff



## Appendix D. Controls Over the Labor Cost Sharing Program

The controls over the LCS program were adequate and no material internal control weaknesses were identified. To evaluate these controls, we verified a statistical sample of KN employees against personnel records, reviewed calendar year and FY 2007 budget and accounting documentation, assessed the cashflow process, verified the certification and accreditation of the pay systems for KN labor, and reviewed the access controls over the KN pay systems.

### Labor Sample

To develop a statistical sample of KN employees, we obtained personnel and payroll databases as of October 2007. We excluded KN employees working for U.S. Naval Forces Korea from the universe because their pay center is in Japan and including them would not have been cost-effective or time-efficient. U.S. Naval Forces employed less than 2 percent of the total KN workforce. The table below shows the universe of KN employees and the respective sample sizes reviewed.

**KN Labor Sample**

<b>Pay Office</b>	<b>Population</b>	<b>Sample Size</b>
175 <sup>th</sup> FMC	8,160	381
51 <sup>st</sup> Comptroller Squadron	866	97
<b>Total</b>	<b>9,026</b>	<b>478</b>

To obtain the sample of 478 employees from the universe, we used a simple random sample design without replacement to randomly select the appropriate sample from each population. We used Excel random number generator to randomize the population. See Appendix A for additional information.

To ensure that the employee database was reliable, we physically validated the identification cards of the employees in the sample against employee identification numbers on file at USFK. Also, we reviewed timesheets and supporting documentation to ensure that there were adequate controls over the timekeeping process. We found one employee whose identification number on the USFK-issued identification card did not match the identification number listed in the personnel and payroll databases. In that case, we determined that it was simply an error on the employee's newly issued identification card, and the employee was to get his identification card fixed. We did not identify any significant issues in the timekeeping process.

### Budget and Accounting Documentation Review

We reviewed calendar year and FY 2007 LCS budget and accounting documentation prepared and maintained by the 175<sup>th</sup> FMC and the 51<sup>st</sup> Comptroller Squadron.

We discussed and observed the processes and reviewed bank statements, deposit slips, disbursement vouchers, log entries, and other supporting documentation.

## **Cashflow Process Assessment**

The LCS cashflow process is discussed in detail in finding B of this report.

## **Certification and Accreditation Verification**

We interviewed USFK officials responsible for verifying the certification and accreditation of the payroll systems for KN labor as a control over the LCS program. Although we obtained a general understanding of the certification and accreditation processes for the payroll systems, we did not test them. We obtained documentation, and the analysis of that information is in Appendix A.

## **Access Control Review**

We interviewed 175<sup>th</sup> FMC officials to obtain an understanding of the access controls for their payroll system. Officials from the 175<sup>th</sup> FMC explained that the payroll system for KN labor operates on the Korea-Wide Area Network, which is not connected to the Internet. Therefore, we determined that it was secure in controlling user access. Additional controls implemented by the 175<sup>th</sup> FMC include the required use of a DoD identification card, user names, and passwords.

We also interviewed officials at the 51<sup>st</sup> Comptroller Squadron to evaluate the access controls over their payroll system for KN labor. Although Squadron officials had access controls in place, they did not adequately document and evaluate those controls. The evaluation of controls over the pay process is discussed in finding C of this report.

## Appendix E. Controls Over Host Nation Funded Construction

The controls over Host Nation Funded Construction were adequate and provided reasonable assurance that projects were completed according to contract specifications and funds were properly managed and distributed.

### Construction Sample

We evaluated the controls by reviewing a sample of projects in the construction phase during our audit. We judgmentally selected a sample of the current projects based on cost. The sample totaled \$207.4 million, representing 60 percent of the total value of projects under construction, as shown in the following table.

**Republic of Korea Host Nation Funded Construction Sample**

<b>Project</b>	<b>Award Amount (millions)</b>	<b>Location</b>
Parcel 1 Land Development	\$47.2	Humphreys
DRMO* Consolidation	43.0	A'po
Middle School and Parking	38.2	Osan Air Base
Community Fitness Center	33.0	Humphreys
Electrical Upgrade	16.5	Rodriguez Range
Vehicle Maintenance Facility	15.0	USAG** Carroll
Upgrade Hardened Aircraft Shelters	10.1	Osan Air Base
Community Activities Center	4.4	Osan Air Base
<b>Total</b>	<b>\$207.4</b>	
*Defense Reutilization and Marketing Office		**U.S. Army Garrison

### Review of Controls - Construction Process

We interviewed resident engineers and reviewed project documentation, including contract documents, final design floor plans, and quality assurance reports. We visited each construction site and compared the final design floor plan to the construction we observed.

We reviewed quality assurance reports at the U.S. Army Corps of Engineers, Far East District (FED) that identified construction deficiencies. We found that FED inspectors completed timely reviews of contractor work, identified discrepancies, and verified with the contractor that discrepancies were corrected.

We reviewed the Army Audit Agency report, A-2006-0133-FFP, "Corps of Engineers Contracting," June 7, 2006, which also concluded that the FED adequately monitored contractor performance to ensure that work was performed according to contract specifications.

## **Review of Controls - Funds**

We reviewed the process for the receipt, maintenance, and disbursement of Host Nation Funded Construction funds. The FED used the Corps' Financial Management System, which is an integrated system that encompasses the entire financial process, including funding, commitments, obligations, expenditures, and disbursements. We identified several controls in the process to ensure funds were properly managed.

We found that key duties, such as procurement, authorization of payment, and disbursing, were effectively segregated. For example, the funds are disbursed by the Corps' Finance Center in Millington, Tennessee, when authorized by the FED Resource Manager. The Finance Center reconciles bank statements to the accounting records, and the FED also reconciles the statements with its records for a second check for accuracy.

We reviewed the internal control checklists related to the following functions: operating budget, revolving fund, and accounting operations. The checklists were comprehensive and provided reasonable assurance that control weaknesses would be detected.

We also reviewed a FED Internal Review office report titled "Review of Republic of Korea Funded Construction-Project Fund Management and Quarterly Report," September 8, 2006. The report stated that the FED properly managed the ROK Host Nation Funded Construction funds.

# Office of the Under Secretary of Defense (Comptroller)/ Chief Financial Officer Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE  
1100 DEFENSE PENTAGON  
WASHINGTON, DC 20301-1100

JUN 30 2008

COMPTROLLER

MEMORANDUM FOR PROGRAM DIRECTOR, JOINT AND OVERSEAS  
OPERATIONS, OFFICE OF INSPECTOR GENERAL,  
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report entitled "Host Nation Support of U.S. Forces in Korea"  
(Project No. D2007-D00LA-0251.000)

This memorandum is in response to the subject May 15, 2008 draft report provided to this office for review and comment. We concur with the Office of Inspector General (OIG), Department of Defense (DoD) Finding A, recommendations 1 and 2, addressed to the Under Secretary of Defense (Comptroller)/ Chief Financial Officer. Our response to the report findings and recommendations is outlined in the attachment.

The Department appreciates the opportunity to comment on the subject report. My staff point of contact on this matter is Ms. Joy Marcou. She can be contacted by telephone at 703-602-0125 or e-mail at joy.marcou@osd.mil.

A handwritten signature in cursive script, appearing to read "D. Smith".

David P. Smith  
Acting Deputy Chief Financial Officer

Attachments:  
As stated

**DoDIG Draft Report on Host Nation Support of U.S. Forces in Korea  
Project No. D2007-D000LA-0251.000**

The Department of Defense Inspector General recommended that the Under Secretary of Defense (Comptroller)/Chief Financial Officer (USD(C)/CFO):

**RECOMMENDATION 1:** Require U.S. Forces Korea (USFK) officials to stop using Republic of Korea burdensharing funds to pay nonappropriated fund (NAF) costs without justification and without the consent of the Republic of Korea.

**DOD RESPONSE:** Concur. A memorandum directing USFK terminate the use of burdensharing funds to offset Korean National NAF personnel costs is in coordination for USD(C)/CFO signature.

**ESTIMATED COMPLETION DATE:** July 30, 2008

**RECOMMENDATION 2:** Recoup the burdensharing funds already distributed to the Dragon Hill Lodge, and redistribute them to pay the U.S. Forces Korea appropriated fund Korean National labor costs.

**DOD RESPONSE:** Concur. A memorandum directing the Command, U.S. Forces Korea to recoup the burdensharing costs already distributed to the Dragon Hill Lodge and use these burdensharing funds to offset appropriated fund costs is in coordination for USD(C)/CFO signature.

**ESTIMATED COMPLETION DATE:** July 30, 2008

# U.S. Forces Korea Command Comments



HEADQUARTERS, UNITED STATES FORCES, KOREA  
UNIT #15237  
APO AP 96205-5237

REPLY TO  
ATTENTION OF:

FKCS

MEMORANDUM FOR Inspector General, Department of Defense, 400 Army Navy Drive,  
Arlington, VA 22202-4704

SUBJECT: Department of Defense Inspector General (DoDIG) Draft Audit Report on Host  
Nation Support of U.S. Forces Korea (Project No. D2007-D000LA-0251.000)

1. Please find enclosed the command reply to the subject draft report. USFK concurs (with comments) with the reported facts, observations, conclusions, and recommendations contained in the Findings B and C of the draft report.
2. POC is Mr. Young J. Jin at DSN (315) 723-3740, Email: [jjinyj@korea.army.mil](mailto:jjinyj@korea.army.mil).

A handwritten signature in black ink, appearing to read "Joseph F. Fil, Jr.", written in a cursive style.

JOSEPH F. FIL, JR.  
Lieutenant General, US Army  
Chief of Staff

Enclosure  
As stated

**U.S. FORCES KOREA COMMAND REPLY**

**DODIG AUDIT OF HOST NATION SUPPORT OF U.S. FORCES IN KOREA  
(PROJECT NO. D2007-D000LA -0251.000)**

**GENERAL COMMENTS**

**Finding B. Labor Cost Sharing Cashflow Process:**

In consultation with the major stakeholders – Defense Finance and Accounting Service (DFAS), 175th Financial Management Center (175th FMC), 7th Air Force (7AF), and Naval Forces Korea (NAVFOR-K)-- we have instituted a series of process changes and improvements to meet the intent of the audit recommendations. For various reasons, including differences in DFAS and Service systems, and accounting and disbursing practices, a "one size fits all" solution is not practical. To the extent possible we have issued interim guidance to all three servicing Korean National (KN) payroll activities in USFK (175th FMC, 7AF and NAVFOR-K) to meet the intent of the DoDIG recommendations. We continue to work with all stakeholders to fully implement a long term practical solution and to codify the revised procedures into future revisions of USFK Regulation 37-2, Republic of Korea (ROK) Labor Cost Sharing (LCS) Program.

We request the DoDIG provide revised recommendations or facilitate policy reviews with DoD Comptroller and DFAS to address the following issues and obstacles preventing full implementation of DoDIG recommendations:

- Due to differences in payroll and disbursing practices, it is proving difficult to establish consistent USFK guidance on what rate to collect and maintain the funds received from the ROK Ministry of National Defense (MND) for LCS. At the heart of this issue are previous rulings by DFAS (and supported by the DoDIG) against using foreign currency fluctuation accounts (FCFA) for any portion of payroll provided by the ROK government.
- When depositing these funds into the "restricted accounts," they need to be held at a consistent rate to avoid daily revaluation that would result in a debit or credit on the FCFA. In order to maintain proper obligation rates without impacting TOA and cause significant budget implications the funds need to be collected and maintained at the DoD established budget rate.
- However, the disbursing systems currently used by Air Force will not accommodate this practice. Air Force conducted a teleconference with DFAS Japan to resolve the issue and the outcome was to recommend a systems (software) update request through DFAS Denver. This could take up to 18 - 24 months to be fully staffed, approved, modified and fielded.

As a result of client comments to the finding an additional recommendation was added. The Recommendations to draft finding B were renumbered. Draft Recommendations B.1, B.2, and B.3 have been renumbered as Recommendations B.1.a, B.1.b, and B.1.c. The additional recommendation is B.2.a and B.2.b.

- This software update would not fully alleviate the need to revalue the currency held, and therefore would result in a debit/credit to the FCFA at year end. Because of the amount of funding received (~71%) and the timing (1 April), funds will be carried over from one fiscal year to the next. In order to avoid impact to the budget and TOA, that currency would have to be revalued at the new budget rate on 1 October; the resulting revaluation would result in a debit/credit to the FCFA.
- DFAS and each servicing disbursing officer establishes limits per DoD FMR Vol 5 on the amount of cash a Deputy Disbursing Officer (DDO) or Disbursing Agent (DA) can have on hand. Under current rules and practices, each of the three servicing payroll activities would have to request an exception to policy to maintain the amount of cash on hand consistent with the DoDIG findings and recommendations.
- Differences, depending on the Service or DFAS who is servicing the particular agency, exist in the way the funds received are posted to the end-user's (customer's) account as some are being treated as Receipts while others as Reimbursements. We believe there should be consistency in this practice and would like to see DFAS issue clear guidance on the issue.

#### **COMMENTS TO RECOMMENDATIONS**

**Recommendation B1.:** Deposit all Labor Cost Sharing (LCS) funds contributed by the Republic of Korea (ROK) into the Restricted Account.

Renumbered as  
Recommendation  
B.1.a.

**USFK Comments:** Concur. USFK directed all three servicing payroll activities to establish a Won denominated "restricted" account to receive, hold and disburse Won received from the ROK government solely for the purpose of Korean National (KN) payroll. We also held discussions with representatives of the ROK Ministry of National Defense (MND), Bureau of Budget and Finance where the Bureau agreed to deposit Won payments directly into the three newly established restricted accounts.

**Recommendation B2.:** Disburse all of the LCS funds contributed by the ROK in Won (preferably by electronic funds transfers) from the Restricted Account.

Renumbered as  
Recommendation  
B.1.b.

**USFK Comments:** Concur. All three servicing payroll organizations have established restricted Won accounts and the ROK government is now depositing Won directly into these accounts. This eliminates the previous practice of multiple disbursements, some by U.S. dollar denominated U.S. Treasury checks, to various LCS participating organizations - including but not limited to the three servicing payroll activities. Under these revised procedures the only disbursements made will be via EFT by the servicing payroll activities.

**Recommendation B3.:** Maintain all LCS funds contributed by the ROK in the Restricted Account until fully disbursed.

**USFK Comments:** Concur.

**Recommendation C1.:** Develop a written description of the controls in place over the KN Pay section.

**USFK (7AF) Comments:** Concur. 7AF developed an Alternate Management Control (AMC) self-inspection checklist providing internal controls specifically targeted to our management of LCS funds. (See attached memorandum from 7AF Commander)

**Recommendation C2.:** Complete documented reviews of the internal control process to provide the basis for annual assessments of the pay process for KN employees.

**USFK (7AF) Comments:** Concur. The AMC checklist was developed in coordination with the USFK staff and serves the dual purpose of (a) documenting our control process, and (b) validating quarterly reviews to ensure effective implementation. The first review was completed 21 May 2008. (See attached memorandum from 7AF Commander)

Renumbered as  
Recommendation  
B.1.c.

# 7th Air Force, U.S. Air Forces Korea Command Comments



DEPARTMENT OF THE AIR FORCE  
HEADQUARTERS SEVENTH AIR FORCE (AIR FORCES KOREA)

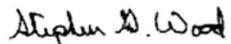
JUN 16 2008

MEMORANDUM FOR USFK IR

FROM: 7 AF/CC

SUBJECT: DoDIG Draft Report - Audit of Host Nation Support of U.S. Forces in Korea  
(D2007 D000LA 251.000)

1. We greatly appreciate the opportunity to collaborate on the DoDIG audit of the Host Nation Support of U.S. Forces in Korea. We concur with the recommendation and have developed an Alternate Management Control (AMC) self-inspection checklist providing internal controls specifically targeted to our management of Host Nation, Labor Cost Sharing funds.
2. The AMC checklist was developed in coordination with the USFK staff and serves the dual purpose of both (a) documenting our control processes, and (b) validating recurring reviews which ensure those processes are being implemented effectively. This checklist was completed on 21 May 2008 and will be executed and validated on a quarterly basis.
3. Should you need any assistance or additional information please contact Maj Deron Mirro, 51 CPTS/CC at 784-5821.

  
STEPHEN G. WOOD  
Lieutenant General, USAF  
Commander

Attachment:  
Completed Self-Inspection Checklist

## **Team Members**

The Department of Defense Office of the Deputy Inspector General for Auditing, Joint and Overseas Operations prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

Donald A. Bloomer

Melinda M. Oleksa

Gordon A. Uscier

Jennifer L. Paper

Jessica R. Frederick

Jessica R. Crotts

Eric W. Kruttschnitt

Lusk F. Penn

James D. Hartman



# Inspector General Department *of* Defense

