Audit Report

DEFENSE LOGISTICS AGENCY FY 1999 PROPERTY, PLANT, AND EQUIPMENT FINANCIAL REPORTING

Report No. D-2000-133 May 30, 2000

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Acronyms

DBMS	Defense Business Management System
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DPAS	Defense Property Accountability System
GAO	General Accounting Office
LLP	Limited Liability Partnership
OMB	Office of Management and Budget
PP&E	Property, Plant, and Equipment
WCF	Working Capital Fund

INSPECTOR GENERAL
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May 30, 2000

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Defense Logistics Agency FY 1999 Property, Plant, and Equipment Financial Reporting (Report No. D-2000-133)

We are providing this report for your information and use. We performed this audit in support of Public Law 101-576, the Chief Financial Officers Act of 1990, as amended by Public Law 103-356, and the Federal Financial Management Act of 1994.

Comments from the Defense Logistics Agency on the draft of this report were sufficiently responsive and further comments are not required

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides at (614) 751-1400, extension 11, e-mail jkornides@dodig.osd.mil, or Mr. John K. Issel at (614) 751-1400, extension 12, e-mail jissel@dodig.osd.mil. See Appendix B for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
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Office of the Inspector General, DoD

Report No. D-2000-133 **May 30, 2000**
(formerly Project No. 0FJ-2105.01)

Defense Logistics Agency FY 1999 Property, Plant, and Equipment Financial Reporting

Executive Summary

Introduction. This report is part of a series of reports resulting from our audit of the FY 1999 Defense Logistics Agency Working Capital Fund Financial Statements. The Defense Logistics Agency's property, plant, and equipment consists primarily of buildings, structures and facilities, but also includes automated data processing and other equipment. Property, plant, and equipment are a material part of the assets on the Balance Sheet of the Defense Logistics Agency financial statements. At the end of FY 1999, the acquisition cost of property, plant, and equipment reported by the Defense Logistics Agency was $2.6 billion. Total Defense Logistics Agency assets of $12.1 billion were reported on the Defense Logistics Agency's FY 1999 Balance Sheet.

Objectives. The overall audit objective was to determine whether the FY 1999 Defense Logistics Agency Working Capital Fund financial statements were prepared in accordance with the Office of Management and Budget Bulletin, "Audit Requirements for Federal Financial Statements." To support our audit of the Defense Logistics Agency financial statements, we focused this part of the audit on the accuracy of property, plant, and equipment reported by the Defense Logistics Agency on the FY 1999 financial statements.

Audit Results. The Defense Logistics Agency needed to make additional efforts to improve the financial reporting of property, plant, and equipment. The Defense Logistics Agency still had significant unreconciled differences between the amounts of property, plant, and equipment reported in its financial statements and the Defense Property Accountability System (a difference of $403 million), and between the amounts reported in the Defense Property Accountability System and the Defense Business Management System (a difference of $551 million). As a result, we could not verify that the $2.6 billion of property, plant, and equipment information shown on the FY 1999 financial statements was complete. Also, the information could not be relied on to accurately represent the value of the Defense Logistics Agency's property, plant, and equipment.

Summary of Recommendations. We recommend that the Director, Defense Logistics Agency, in coordination with the Defense Finance and Accounting Service, direct resources to develop and implement procedures to resolve differences between the property, plant, and equipment recording systems and the financial recording systems and correct the differences. Also, we recommend that the Defense Logistics Agency disclose the weaknesses in financial reporting and management controls that affect property, plant, and equipment reporting in footnotes to the financial statements.

Management Comments. The Chief, Program/Budget Group, stated that the Deputy Director, Defense Logistics Agency, would work with the Defense Finance and

Accounting Service and the Defense Logistics Support Center to reconcile differences between the Defense Property Accountability System and the Defense Business Management System. He also said that in the footnotes to the FY 2000 financial statements, the Defense Logistics Agency will cite any unresolved weaknesses that affect property, plant, and equipment. See the Finding section for a summary of management comments and the Management Comments section for the complete text of the comments.

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Background

Introduction. The audit was performed as part of our effort to meet the requirements of 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. The legislation requires financial statement audits by the Inspector General (IG), DoD, prescribes management's and auditors' responsibilities, and requires internal controls and compliance with laws and regulations. The Office of Management and Budget (OMB) Bulletin, "Audit Requirements for Federal Financial Statements," establishes the minimum requirements for audits of Federal financial statements. On July 21, 1999, the Under Secretary of Defense (Comptroller) designated the Defense Logistics Agency (DLA) Working Capital Fund (WCF) a DoD reporting entity with a requirement to prepare audited financial statements.

Property, plant, and equipment (PP&E) is a material part of the assets on the Balance Sheet of the DLA financial statements. DLA PP&E consists primarily of buildings, structures, and facilities, but also includes automated data processing and other equipment. At the end of FY 1999, the acquisition cost of PP&E reported by DLA was $2.6 billion. Total assets of $12.1 billion were reported on the DLA FY 1999 Balance Sheet.

The following table shows the types of PP&E reported in the FY 1999 DLA financial statements.

Six Classes of PP&E Reported by DLA
(Thousands)

Type of PP&E	Value
Land	$ 0
Buildings, Structures, and Facilities	1,692,248
Leasehold Improvements	531
Automated Data Processing	144,827
Equipment	614,378
Assets Under Capital Lease	0
Construction in Progress	148,767
Other	312
Total	**$2,601,063**

The cumulative amounts shown above represent the acquisition values of the PP&E.

processing and other equipment is considered personal property. During FY 1999, KPMG LLP, a certified public accounting firm under contract to DoD, performed a limited review of personal property at DLA. The results of that review are included in the Finding section of this report.

DLA Actions to Improve PP&E Reporting

The IG, DoD, has issued prior audit reports (see Appendix A) disclosing material inaccuracies in the DLA financial reporting of PP&E. The reports noted that DLA could not produce reliable financial data because of the lack of adequate procedures, controls, and accounting systems. For each report, DLA has agreed to take action to correct identified weaknesses. As a result of the DLA efforts, the value of the reported PP&E increased from $319 million for FY 1993 to $2.6 billion for FY 1999.

Improvements Made. The significant increase in the value of the PP&E reported by DLA occurred because DLA had improved the quality of its PP&E financial reporting. In order to more reflect the PP&E balance more accurately, DLA had performed inventories of some of its assets and entered data into the Defense Property Accountability System (DPAS). In addition, DLA personnel had attempted to resolve known weaknesses in the financial reporting of PP&E.

In August 1998, personnel in the DLA Comptroller's office recognized that the financial data for PP&E were still misstated and developed a plan of action and milestones for DLA to continue improving the financial reporting of PP&E. The timeline for improving the data extended through FY 1999.

Objectives

The overall objective of our audit was to determine whether the FY 1999 DLA Working Capital Fund (WCF) financial statements were prepared in accordance with the OMB Bulletin, "Audit Requirements for Federal Financial Statements." To support our audit of the DLA financial statements, we focused this part of the audit on PP&E reporting by DLA.

Reporting of Property, Plant, and Equipment in the Defense Logistics Agency FY 1999 Financial Statements

The DLA still had significant unreconciled differences between the amounts of PP&E reported in the DLA FY 1999 financial statements and the Defense Property Accountability System (DPAS) (a difference of $403 million) and the amounts reported in the DPAS and the Defense Business Management System (DBMS) (a difference of $551 million). The differences existed because:

- Some existing and new PP&E assets were not entered into DPAS.
- Data elements in DPAS and DBMS did not agree.
- Differences between the systems were not reconciled.
- Accuracy was affected by a lack of training in operating the property system, delays in recording assets, and the method of funding the acquisition of assets.

Additionally, although DLA reported financial reporting challenges in the FY 1999 financial statements, DLA did not reflect material reporting weaknesses concerning PP&E. As a result of these control and reporting deficiencies, we could not verify that the $2.6 billion of PP&E shown on the FY 1999 financial statements was complete and could be relied on to accurately represent the value of DLA PP&E.

Financial Reporting Policy

DoD 7000.14-R, the "DoD Financial Management Regulation," volume 6, "Reporting Policy and Procedures," January 1998, chapter 2, "Departmental Financial Reports - Roles and Responsibilities," February 1996, requires DoD activities to be responsible for:

- ensuring the accuracy, completeness, timeliness, and documentary support of all data generated by customers and input electronically into finance and accounting systems or submitted to the Defense Finance and Accounting Service (DFAS) for input or recording in the finance and accounting systems and inclusion in financial reports.
- establishing appropriate internal controls to ensure the accuracy of data provided to DFAS.
- reviewing all reports provided by DFAS to assess the accuracy of financial information being reported.

The DoD policy requires WCF activities to capitalize and report all assets with an acquisition value of $100,000 or more and a useful life of 2 or more years. Capital assets include, but are not limited to physical plant and property (including minor construction), equipment, and software.

In a September 30, 1998, memorandum, "Accuracy of Property Accountability Records for Property, Plant, and Equipment (PP&E) (Real and Personal Property)," the Under Secretary of Defense for Acquisition and Technology restated guidance issued in March 1991 that the Military Departments and Defense agencies must:

- ensure that periodic inspections and inventories include a requirement to verify that all property is properly recorded;
- ensure that all PP&E records and systems are complete and accurate;
- verify that all physical inventories of PP&E comply with DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Accounting Policy and Procedures," November 1999, chapter 1, "Financial Control of Assets, September 1999, and chapter 6, "Fixed Assets," January 1995;
- perform periodic reconciliations (at a minimum, at the end of the fiscal year) between installation-level and centralized real and personal property systems;
- ensure that all PP&E not otherwise inspected or inventoried in accordance with regulatory guidance by June 30, 1999, is inspected or inventoried; and
- ensure that the property accountability records reflect the results of periodic inspections and inventories.

DLA Property Systems

PP&E Systems. DLA activities record PP&E in multiple systems. For custodial and asset management purposes, DLA WCF activities use the Base Operations Support System to record personal property and the Integrated Facilities System to record real property. These systems were primarily designed to monitor custody or maintenance and do not meet Federal financial reporting requirements.

For financial reporting purposes, DLA uses two systems, DPAS and DBMS. To financially report PP&E, DLA activities, except the Defense Automated Printing Service, must record each asset in DPAS. For the Defense Automated Printing Service, PP&E is recorded in the property accountability module of the Defense Working Capital Fund Accounting System. Unlike DPAS, the Defense Working Capital Fund Accounting System is a transaction-driven accounting system that does not require integration with another system for financial reporting of PP&E. Data are entered from support documents during the acquisition process and then affect the appropriate accounts. To record an asset in DPAS, data are obtained from source documents or from the custody and maintenance systems and then entered into DPAS. DPAS establishes a matching record for the asset in DBMS, the accounting and finance system used to support DLA.

Improvements Needed

DLA needed to continue improving the financial reporting of PP&E.

Differences in Amounts Reflected in Systems. The value of PP&E shown in DBMS, the financial reporting system for DLA, was $3.555 billion. However, the PP&E accountability system, DPAS, reported $3.004 billion, or a net value of $551 million less. We discussed the difference between DBMS and DPAS with personnel at DFAS and the DLA Comptroller's office to determine the probable causes. DFAS and DLA personnel indicated that:

- At least two major DLA activities, the DLA Philadelphia Center, Philadelphia, Pennsylvania, and DLA headquarters, Fort Belvoir, Virginia, had not input all their PP&E into DPAS. Partial closure and movement of the facilities at the DLA Philadelphia Center caused a delay in inputting all PP&E into DPAS. A shortage of trained personnel was also blamed for the lack of input at the DLA Philadelphia Center. Headquarters personnel were in the process of inputting data, but those actions were not completed during FY 1999.

- DFAS became aware of the acquisition of new DLA assets or transfers-in of existing assets through financial documents or transactions and created a property record in DBMS. It is the responsibility of DLA personnel to enter data that would create a matching record in DPAS, but they had not always done so.

- Data elements in the two systems did not always match. DLA and DFAS personnel stated that there could be differences in the two systems, such as a different dollar value for acquisition cost or different serial numbers. This could result in significant differences in the recorded values in the two systems.

DLA and DFAS personnel were developing procedures for resolving differences among the reporting systems. For example, DLA established a plan to develop an interface between the custody system, the Base Operations Support System, and the reporting system, DPAS. The projected completion date for the interface is the end of FY 2000. Additionally, DLA and DFAS had not yet developed procedures for each entity to resolve the differences.

Additionally, the DLA financial statements reported $2.601 billion, which was $403 million lower than the DPAS amounts. DLA personnel had stated that adjustments made to the DPAS amounts resulted in the lower amount on the financial statements. We did not audit the adjustments.

Management Controls. In August 1999, KPMG LLP was hired by DLA to perform a limited review of DLA internal controls and procedures over recording personal property. The KPMG report, issued in December 1999, identified two major management control weaknesses.

- At some DLA activities, employees were learning to operate the system used to record capital assets, and only one employee was trained in the use of the system.

- Direct shipment of property to operating locations translated into delays in recording assets, because the operating locations did not send information promptly to headquarters.

To correct these weaknesses, KPMG LLP recommended that DLA:

- encourage personnel at the operating locations to attend DPAS training and ensure that at least two employees are trained on DPAS, and

- establish procedures to ensure that operating locations provide timely transaction information to headquarters.

At the time of our audit, DLA had not implemented these recommendations.

Financial Statement Disclosure

The DLA FY 1999 Annual Statement of Assurance reflected an uncorrected management control weakness in the financial reporting of PP&E. However, this information was not reflected in DLA financial reporting.

In Footnote 9, General (PP&E) Net, DLA did not disclose a management control and financial reporting weakness. The IG, DoD, in Report No. 99-142, "Defense Logistics Agency FY 1998 Property, Plant, and Equipment Financial Reporting," April 26, 1999, recommended that DLA "disclose in the financial statements known weaknesses in financial reporting and management control weaknesses that affect the financial statements." The Deputy Director, DLA, concurred with the recommendation and stated, "In FY 1999, any management control weaknesses identified will be disclosed." KPMG LLP restated PP&E weaknesses in their report. However, our followup indicated that no actions were taken to incorporate the weaknesses in PP&E reporting in the footnotes to the financial statements. To ensure full disclosure, PP&E weaknesses should be described in Footnote 9.

Recommendations, Management Comments and Audit Response

We recommend that the Director, Defense Logistics Agency:

1. In coordination with the Defense Finance Accounting Service, direct resources to develop and implement procedures to resolve the differences between the property, plant, and equipment recording systems and the financial recording systems and correct the differences.

Management Comments. The Chief, Program/Budget Group, concurred for the Deputy Director, DLA, stating that DLA will work with DFAS and the Defense Logistics Support Center to reconcile differences between the Defense Property Accountability System and the Defense Business Management System.

2. Disclose in the footnotes to the Defense Logistics Agency financial statements the weaknesses in financial reporting and management controls that affect property, plant, and equipment reporting.

Management Comments. The Chief, Program/Budget Group, partially concurred for the Deputy Director, DLA. The planned action, to cite any unresolved weaknesses that affect property, plant, and equipment in footnotes to the FY 2000 financial statements, met the intent of our recommendation.

Appendix A. Audit Process

Scope and Methodology

We examined the $2.6 billion of financial information related to DLA PP&E that was summarized in the financial statements. We also reviewed related information in reports produced by DLA from its financial systems.

We performed the audit by making inquires of DFAS and DLA Comptroller staff to determine the progress DLA has made toward improving its PP&E reporting. This financial-related audit was conducted from September through February 2000 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

We did not assess the reliability of computer-processed data. However, not assessing the reliability of the data did not affect the results of the audit.

Contacts During the Audit. We visited or contacted individuals or organizations within DoD and DLA. Further details are available on request.

DoD-wide Corporate-Level Government Performance and Results Act (GPRA) Coverage. In response to the GPRA, 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 objective and goal:

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-2)**

- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**
- **FY 2001 Performance Measure 2.5.1:** Reduce the number of noncompliant accounting and finance systems. **(01-DoD-2.5.1.)**
- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2.)**

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

- **Objective:** Strengthen internal controls.

- **Goal:** Improve compliance with the Federal Managers' Financial Integrity Act, as codified in 31 U.S.C. 3512. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in the Department of Defense. This report provides coverage of the financial management high-risk area.

Management Control Program

DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. Procedures for implementing the Directive are outlined in DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996.

Scope of Review of the Management Control Program. We did not perform a full review of the adequacy of DLA controls over the accounting and reporting for PP&E. KPMG LLP had performed a summary review of controls and DLA had identified management control weaknesses in its FY 1999 Annual Statement of Assurance.

Summary of Prior Coverage

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

Appendix B. Report Distribution

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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 Management, Information, and Technology, Committee on Government Reform
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Defense Logistics Agency Comments

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APR 17 2000

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Defense Logistics Agency (DLA) Fiscal Year (FY) 1999 Property, Plant, and Equipment Financial Reporting, Project No OFI-2105 01

In response to Recommendation 1, the Deputy Director, DLA, concurs that DLA will work with the Defense Finance and Accounting Service as well as the Defense Logistics Support Center to reconcile differences between the Defense Property Accountability System and the Defense Business Management System

In response to Recommendation 2, the Deputy Director, DLA, partially concurs. In addition to disclosing known weaknesses in financial reporting in the Annual Statement of Assurance and the Management Discussion and Analysis of Fiscal Year Operations and Financial Conditions; DLA will cite any known weaknesses that are still unresolved and affect property, plant, and equipment in footnotes to the DLA FY 00 financial statements

If you have any questions, please contact Mr. Terry Brill of my staff on (703) 767-7252

Michael F Miller

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