Audit

Report

DEFENSE LOGISTICS AGENCY FY 1998 PROPERTY, PLANT, AND EQUIPMENT FINANCIAL REPORTING

Report No. 99-142 April 26, 1999

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Department of Defense

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Acronyms

DBMS	Defense Business Management System
DLA	Defense Logistics Agency
DPAS	Defense Property Accountability System
DRMS	Defense Reutilization and Marketing Service
GAO	General Accounting Office
PP&E	Property, Plant, and Equipment
WCF	Working Capital Fund

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

April 26, 1999

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

SUBJECT: Audit Report on Defense Logistics Agency FY 1998 Property, Plant, and Equipment Financial Reporting (Report No. 99-142)

We are providing this report for information and use. We performed the audit as part of our responsibility for auditing the Defense Logistics Agency financial statements. We considered management comments on a draft of this report when preparing the final report.

Comments from the Deputy Director, Defense Logistics Agency, on the draft of this report, conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are 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 (6143) 751-1400, extension 12, e-mail jissel@dodig.osd.mil. See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-142 **April 26, 1999**
(Project No 9FJ-2005.01)

Defense Logistics Agency FY 1998 Property, Plant, and Equipment Financial Reporting

Executive Summary

Introduction. The audit was performed in support of our work to meet the requirements of Public Law 101-576, the Chief Financial Officers Act of 1990, as amended by Public Law 103-356, the Federal Financial Management Act of 1994. This report is the second in a series of reports resulting from our audit of the Defense Logistics Agency Working Capital Fund Financial Statements for FY 1998.

Defense Working Capital Fund activities, such as the Defense Logistics Agency, must account for and report in their annual financial statements assets used in providing goods and services to DoD. If the assets used to provide goods and services have an expected life of 2 or more years and cost $100,000 or more, the Working Capital Fund activities recognize the assets by capitalizing them. If not capitalized, an asset's acquisition costs are expensed in the year received. Capitalization occurs when an asset is recognized in the financial statements and the acquisition cost is distributed over a determined number of years (depreciation). Assets that should be capitalized include real property, facilities (for example, buildings), and major equipment items (for example, material handling equipment). At the end of FY 1998, the reported acquisition cost of assets for the Defense Logistics Agency, was $2.2 billion.

Objectives. The overall objective of our audit was to determine whether the Defense Logistics Agency Working Capital Fund Financial Statements for FY 1998 were prepared in accordance with Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. To support our audit of the Defense Logistics Agency financial statements, we focused this part of the audit on property, plant, and equipment reporting by the Defense Logistics Agency.

Audit Results. The Defense Logistics Agency has improved the reporting of property, plant, and equipment. The amount of property, plant, and equipment increased from the $319 million reported in FY 1993 to $2.2 billion reported in FY 1998. However, information from the Defense Finance and Accounting Service and the Defense Logistics Agency showed that Defense Logistics Agency personnel were not entering all existing or newly purchased assets into the Defense Property Accountability System. Also, the Defense Logistics Agency did not have centralized control over the inventories and financial reconciliation of its property, plant, and equipment. As a result, we could not verify that the $2.2 billion of property, plant, and equipment information shown on the FY 1998 financial statements was complete and could 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, identify the differences in the amounts of property, plant, and equipment recorded in the financial systems and the Defense Property Accountability System and correct the errors; establish a plan to direct, manage, and validate completeness and accuracy for property, plant, and equipment, and to perform an annual reconciliation of the financial systems to the supporting records; and disclose in the Defense Logistics Agency financial statements known weaknesses in the financial reporting of property, plant, and equipment, and management control weaknesses that affect the financial statements.

Management Comments. The Deputy Director, Defense Logistics Agency, stated that the Defense Logistics Agency would work with the Defense Finance and Accounting Service to identify differences between the amounts of property, plant, and equipment recorded in the financial statements and the Defense Property Accountability System; establish a plan to validate the completeness and accuracy of property, plant, and equipment; and disclose any management control weaknesses involving property, plant, and equipment in the FY 1999 financial statements. See the Finding section for a summary of management comments and the Management Comments section for the complete text of those comments.

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Background

Introduction. The audit was performed in support of Public Law 101-576, the Chief Financial Officers Act of 1990, as amended by Public Law 103-356, the Federal Financial Management Act of 1994. This report is the second in a series of reports resulting from our audit of the Defense Logistics Agency (DLA) Working Capital Fund (WCF) Financial Statements for FY 1998.

Defense WCF activities such as DLA must account for and report in their annual financial statements assets used in providing goods and services to DoD. If the assets used to provide goods and services have an expected life of 2 or more years and cost $100,000 or more, the WCF activities recognize the assets by capitalizing them. If not capitalized, an asset's acquisition costs are expensed in the year received. Assets that should be capitalized include real property, facilities (for example, buildings), and major equipment items (for example, material handling equipment). At the end of FY 1998, the reported acquisition value of property, plant, and equipment (PP&E) for DLA was $2.2 billion. The following table shows the types of PP&E reported in the DLA WCF Financial Statements for FY 1998.

Six Classes of PP&E Reported by DLA

Type of PP&E	**Value**
Land	$ 0
Structures, Facilities, and Leasehold Improvements	1,548,618,515
Automated Data Processing	15,147,952
Equipment	499,984,447
Assets Under Capital Lease	0
Construction in Progress	143,767,893
Other	76,752
Total	**$2,207,616,361**

The cumulative amounts shown in the table represent the acquisition value of the PP&E.

Objectives

The overall objective of our audit was to determine whether the DLA WCF Financial Statements for FY 1998 were prepared in accordance with Office of Management and Budget Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. 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 Defense Logistics Agency FY 1998 Financial Statements

Although DLA improved the reporting of PP&E, significant unreconciled differences exist between the amount of PP&E reported in the DLA FY 1998 financial statements ($2.2 billion), the Defense Business Management System ($3.4 billion), and the Defense Property Accountability System ($2.8 billion). These differences existed because:

- some DLA activities did not attempt to enter PP&E into DPAS,
- some newly purchased assets were not entered into DPAS, and
- some PP&E was likely being recognized as construction-in-process in DBMS despite software changes to correct this.

Further, DLA did not have centralized control over the inventories and financial reconciliation of its PP&E. As a result, we could not verify that the $2.2 billion of PP&E information shown on the FY 1998 DLA financial statements was complete and accurately represented the value of PP&E.

Financial Reporting Policy

DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," volume 4, "Reporting Policy and Procedures," January 1998, requires DoD activities to be responsible for:

- Ensuring accuracy, completeness, timeliness, and documentary support for all data generated by customers and input electronically into finance and accounting systems or submitted to DFAS for input or recording in the finance and accounting systems and inclusion in financial reports.
- Establishing appropriate internal controls to assure 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.

DLA Actions to Improve PP&E Reporting

The IG, DoD, issued six audit reports (see Appendix A) disclosing material inaccuracies in DLA financial reporting of PP&E and stating that, because of the lack of adequate procedures, controls, and accounting systems, DLA could not produce reliable financial data. To correct the reported problems, DLA took action by issuing guidance, "Financial Recording of Capital Assets," on October 17, 1994. The guidance required DLA organizations to develop a list of all capital assets by performing a complete inventory and entering the results into financial records. Before FY 1997, this information was collected by some activities, and DLA performed reconciliations at some reporting organizations, to validate the accuracy of the financial data.

As a result of the DLA efforts, the value of the reported PP&E significantly increased. Reported PP&E values increased from $319 million for FY 1993 to $2.2 billion for FY 1998.

Improvements Made. The significant rise in the value of the PP&E reported by DLA occurred because DLA had improved the quality of its PP&E financial reporting. Specifically, DLA had performed inventories of some of its assets and had entered much of the data into DPAS. Also, DLA personnel were attempting 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 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 extends through FY 1999.

Improvements Needed. Our review of preliminary data for FY 1998 indicated that DLA needs to continue improving the financial reporting of PP&E.

Differences in Amounts Reflected in Systems. For FY 1998, the financial system used by DFAS to support DLA and the property recording system (DPAS) showed different values for PP&E. The value of PP&E shown in the Defense Business Management System (DBMS), the financial reporting system for DLA, was $3.375 billion. The PP&E recording system, DPAS, reported $2.755 billion, or $620 million less. We discussed the difference between DBMS and DPAS with personnel at DFAS and the DLA Comptroller's office to determine probable causes of the $620 million difference. DFAS and DLA personnel indicated that:

- At least two major DLA activities (Richmond Center and DLA Headquarters) had not input at least $150 million of their PP&E into DPAS in FY 1998.

- Not all newly purchased assets were entered into DPAS. For example, about $40 million of new acquisitions for the former Western Region depots were not entered.

- Because of manual workarounds used with the Base Operations Support System, older assets at an activity could have been recorded in the financial system without being recorded in DPAS.

- The Distribution Standard System software that supports the distribution depots has been installed and recognized, but some PP&E may still be reflected as construction-in-progress in DBMS.

Additionally, the DLA financial statements reported $2.207 billion, which was $548 million lower than the DPAS amounts. DLA personnel stated that adjustments to the DPAS amounts had resulted in the lower amount on the financial statements. We did not audit the adjustments.

Centralized Control and Inventory of DLA PP&E. DLA did not have centralized control over the inventory and financial reconciliation of its PP&E. Periodic inventories of PP&E were not centrally managed, and DLA personnel could not provide sufficient information to confirm that the amounts reported were complete.

DLA has not complied with the guidance issued in March 1991 and recently republished by DoD. 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 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, chapters 1 and 6;

- perform periodic reconciliations (at a minimum, at fiscal year's end) between installation-level and centralized real and personal property systems;

- ensure that all PP&E is inspected or inventoried by June 30, 1999; and

- ensure that the property accountability records reflect the results of periodic inspections and inventories.

In a November 20, 1998, memorandum responding to the Under Secretary of Defense for Acquisition and Technology, DLA stated, "DLA has promulgated a property accountability policy which requires field activities to ensure that inventory inspections and related records are current and accurate, thus satisfying the principal requirements addressed in your letter of September 30, 1998, concerning General PP&E."

On November 20, 1998, DLA issued a memorandum to field activities, titled "Accuracy of Property Accountability Records for Property, Plant, and Equipment (PP&E)." The memorandum directed the field activities to ensure that a 100-percent wall-to-wall inventory of PP&E had been completed within the past 3 years for personal property and the past 5 years for real property. The field activities were directed to provide written assurance of the inventories by April 30, 1999.

DLA personnel stated that field activities in the western portion of DLA operations had completed a wall-to-wall inventory of PP&E. Deficiencies in inventorying PP&E in the western portion of DLA were identified in IG, DoD, Report No. 97-148, "Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting," May 29, 1997. At that time, we estimated that $234 million of PP&E was not inventoried and reported by the former Western Region (after Report No. 97-148 was issued, the Western Region was consolidated with the Eastern Region). DLA personnel stated that they had received a certification that after the audit work on Report No. 97-148 was complete, an inventory of all PP&E was completed in the former Western Region. However, we could not verify the inventory because DLA could provide no records to support the certification. We attributed this problem to the lack of central management of the PP&E inventories.

We concluded that DLA needs a plan for central management and validation of the completion and accuracy of PP&E inventory.

Systems Issues

PP&E Systems. PP&E in DLA, with the exception of the Defense Automated Printing Service, must be recorded in DPAS. DPAS then transmits summarized information to the DBMS for financial reporting purposes. However, DPAS and DBMS did not contain the information needed to meet FY 1998 Federal financial management and reporting standards, including the use of the U.S. Government Standard General Ledger at the transaction level.

Additionally, 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 system that does not require integration with another system for financial reporting of PP&E. At the time of the audit, DFAS was reviewing the Defense Working Capital Fund Accounting System to determine whether the system was compliant with requirements for Federal financial management and reporting.

Other Systems. DLA activities also record PP&E in various other systems, such as the Base Operations Support System, the Integrated Facilities System, and the Real Property Maintenance System. These systems were primarily designed to monitor accountability or maintenance. However, past audits have shown that PP&E recorded in these systems has not always been recognized in the financial records of DLA. Periodic inventories and reconciliations are intended to correct or prevent that condition. However, we were not able to determine whether DLA had performed a complete, centrally managed, effective inventory and reconciliation of its PP&E.

DLA Statement of Assurance

Footnotes to the Statements. In its FY 1998 Annual Statements of Assurance, DLA reported material management control weaknesses in the financial reporting of PP&E. However, DLA did not show the weaknesses in the footnotes to its financial statements in FY 1998. To ensure full disclosure, DLA should report any management control weaknesses that affect the financial statements in the footnotes to the financial statements.

Accounting Principles

DLA has stated that its financial statements were prepared in accordance with Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, as amended November 29, 1998. These Bulletins incorporate the Statements of Federal Accounting Concepts and Standards recommended by the Federal Accounting Standards Advisory Board. The standards are approved by the Secretary of the Treasury; the Director, OMB; and the Comptroller General of the United States, and are implemented by the Under Secretary of Defense (Comptroller). Our prior and current audit work disclosed that the financial management systems used by DFAS and DLA did not comply with Federal financial management system requirements, applicable Federal accounting standards, and the requirement for using the U.S. Government Standard General Ledger at the transaction level. As a result, the PP&E accounts are unlikely to be fairly presented.

Defense Automated Printing Service

In addition to the above issues, the Defense Automated Printing Service had an undetermined amount of real property that was not reflected on the financial statements. In IG, DoD, Report No. 98-201, "FY 1997 Financial Reporting by the Defense Automated Printing Service," September 23, 1998, we reported that the Defense Automated Printing Service did not include any of its real property facilities in its financial statements. All Defense Automated Printing Service real property should be reported by the Defense Automated Printing Service and DLA.

Recommendations and Management Comments

We recommend that the Director, Defense Logistics Agency:

1. In coordination with the Defense Finance and Accounting Service, identify the differences in the amounts of property, plant, and equipment recorded in the financial systems and the Defense Property Accountability System and correct the errors.

Management Comments. The Deputy Director, DLA, concurred and stated that DLA will work with DFAS to reconcile differences between the Defense Property Accountability System and the Defense Business Management System.

2. Establish a plan to direct, manage, and validate completeness and accuracy for property, plant, and equipment, and to perform an annual reconciliation of the financial systems to the supporting records.

Management Comments. The Deputy Director, DLA, concurred and stated that DLA had established a plan to validate completeness and accuracy for property, plant, and equipment.

3. Disclose in the Defense Logistics Agency financial statements known weaknesses in the financial reporting of property, plant, and equipment, and management control weaknesses that affect the financial statements.

Management Comments. The Deputy Director, DLA, concurred and stated that in Note 6 to the FY 1998 principal financial statements, DLA cited known weaknesses in the financial reporting of PP&E. In FY 1999, any management control weaknesses identified will be disclosed.

Appendix A. Audit Process

Scope and Methodology

DLA reported $2.2 billion in property, plant and equipment in its FY 1998 financial statements. We examined 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 December 1998 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) Goals. In response to the GPRA, the Department of Defense has established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal:

- **Objective:** Fundamentally reengineer DoD and achieve a 21st century infrastructure.

- **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

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. **(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 reviewed the adequacy of DLA controls over the accounting and reporting for PP&E. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Management Controls. In its FY 1998 Annual Statement of Assurance, DLA reported material management control weaknesses in the financial reporting of PP&E. We identified additional material weaknesses in DLA accounting and reporting for PP&E. If implemented, Recommendations 1. and 2. will assist in correcting the weaknesses. A copy of the report will be provided to the senior official responsible for management controls for DLA.

Appendix B. Summary of Prior Coverage

The IG, DoD, has issued six audit reports prior to FY 1999 related to DLA financial reporting of PP&E.

Report No. 98-201, "FY 1997 Financial Reporting by the Defense Automated Printing Service," September 23, 1998.

Report No. 97-148, "Defense Logistics Agency Actions to Improve Property, Plant, and Equipment Financial Reporting," May 29, 1997.

Report No. 97-097, "Capitalization of Software Developed for the Distribution Standard System," February 19, 1997.

Report No. 95-197, "Statement of Financial Position for the Defense Logistics Agency Distribution Depot Business Area of the Defense Business Operations Fund, as of September 30, 1994," May 19, 1995.

Report No. 94-149, "Property, Plant, and Equipment Accounts on the Financial Statements of the Defense Logistics Agency Business Area of the Defense Business Operations Fund for FY 1993," June 28, 1994.

Report No. 94-035, "Financial Reporting Procedures for Defense Distribution Depots - Defense Logistics Agency Business Area of the Defense Business Operations Fund," February 8, 1994.

Appendix C. Report Distribution

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Defense Logistics Agency Comments

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IN REPLY REFER TO DDAI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING DEPARTMENT OF DEFENSE

SUBJECT: Defense Logistics Agency FY 1998 Property, Plant, and Equipment Financial Reporting (Project No. 9FJ-2005.01)

This is in response to your February 26, 1999 request for comments on the above draft report. If you have any questions, please contact Ms. Annell Williams, 703-767-6274.

Encl

JEFFREY GOLDSTEIN
Chief, Internal Review Office

MAR 24 1999

Subject: Defense Logistics Agency FY 1998 Property, Plant, and Equipment Financial Reporting, 9FJ-2005.01

Finding: The Defense Logistics Agency has improved the reporting of property, plant, and equipment. However, information from the Defense Finance and Accounting Service and the Defense Logistics Agency showed that DLA personnel were not entering all existing or newly purchased assets into the Defense Property Accountability System. Also, DLA did not have centralized control over the inventories and financial reconciliation of its property, plant, and equipment. As a result, the DoD-IG could not verify that the $2.2 billion of property, plant, and equipment information shown on the FY 98 financial statements was complete and could be relied on to accurately represent the value of the Defense Logistics Agency's property, plant, and equipment.

DLA Comments: Concur. DLA is working to correct the discrepancy in FY 99.

Recommendation 1: Recommend that the Director, Defense Logistics Agency in coordination with the Defense Finance Accounting Service, identify the differences in the amounts of property, plant, and equipment recorded in the financial systems and the Defense Property Accountability System and correct errors.

DLA Comments: Concur. Defense Logistics Agency will work in conjunction with Defense Finance and Accounting Service to reconcile differences between the Defense Property Accountability System and the Defense Business Management System.

Disposition: Ongoing. ECD: September 30, 1999

Recommendation 2: Recommend that the Director, Defense Logistics Agency establish a plan to direct, manage, and validate completeness and accuracy for property, plant, and equipment, and to perform an annual reconciliation of the financial systems to the supporting records.

DLA Comments: Concur. Defense Logistics Agency has established a plan (copy attached) to validate completeness and accuracy for property, plant, and equipment. Included in this plan is an annual reconciliation milestone.

Disposition: Considered Complete

Recommendation 3: Recommend that the Director, Defense Logistics Agency disclose in the Defense Logistics Agency financial statements known weaknesses in the financial reporting of property, plant, and equipment, and management control weaknesses that affect the financial statements.

DLA Comments: Concur. Defense Logistics Agency cited (in Note 6 to the FY 98 principal financial statements) known weaknesses in the financial reporting of property, plant, and equipment. In FY 99, any management control weaknesses identified will be disclosed.

Disposition: Considered Complete

Action Officer: Wayne C. Williams, FOXS, 767-7236
Review: Jim O'Laughlin/B.A.Blackman, FOX
Coordination: Annell W. Williams, DDAI, 767-6274

DLA Approval:

E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

ATTACHMENT

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