092885
00315

UNITED STATES GENERAL ACCOUNTING OFFICE
REGIONAL OFFICE
ROOM 403, U.S. CUSTOMHOUSE, 610 SOUTH CANAL STREET
CHICAGO, ILLINOIS 60607

AUG 12 1970

DLG05869

LM092885

Captain Forest M. Clingan, USN
Commanding Officer
Naval Ordnance Station
Forest Park, Illinois 60130

Dear Sir:

We have made a review of the accounting system for Naval Ordnance Systems Command Activities of the Navy. This included a review of the system in operations at Naval Ordnance Station, Forest Park, Illinois. Our review was made pursuant to the Accounting and Auditing Act of 1950 (33 U.S.C. 66) based on a request by the Assistant Secretary of Defense (Comptroller) for approval of the accounting system as conforming in all material respects with the accounting principles and standards in Title 2 of the General Accounting Office Policy and Procedures Manual for the Guidance of Federal Agencies.

Our reply to the request for approval of the system is being directed to the Assistant Secretary of Defense (Comptroller), with more detailed recommendations to the Assistant Comptroller/Director of Financial Management Services, Department of the Navy. Also, we are furnishing a copy of this letter with recommended improvements in procedures and practices that may be applicable to other Naval Ordnance Activities to the Commanding Officer, Naval Ordnance Systems Command.

As we discussed with you at the conclusion of our review, we noted some procedures and practices which we believe to need strengthening or improvement at the station level. These are presented in the following paragraphs for your consideration and follow-up action.

FINANCIAL CONTROLS OVER INVENTORIES

Our review disclosed that the station did not employ procedures necessary to control and accurately account for direct material and supplies inventories. Some of the procedures were required by the NIF Handbook or the Naval Supply Manual.

714540 092885

Our review showed that there was a time span of 2 to 3 years between physical inventories of individual item groups. Station instructions require annual inventories; however, station personnel informed us that taking physical inventories was considered a relatively low priority requirement because of manpower shortages.

We found that the station did not adjust the monetary balances of the stock control ledger to agree with the monetary balances as determined by physical counts of individual item groups. The station adjusts the stock cards to agree with physical counts. It does not, however, determine that the balances of the adjusted stock cards, in total, and the stock control ledger agree with the physical counts. This reconciliation procedure is required by the Naval Supply Manual (sections 24568 and 24586).

We also found that discrepancies between stock cards and physical counts of allocated material were routinely disposed of by charging or crediting job orders. Investigations were not made to determine underlying causes of discrepancies, which might include theft, misplaced or mislabeled inventory. The station's practices could also result in double charging or erroneous crediting of job orders.

Our review disclosed that the station has not been able to perform the monthly reconciliation of the general ledger balances with the stock control ledger as required by the NIF Handbook (section 4104.5.a). We found that the unreconcilable monthly variances for fiscal year 1969 were as much as $300,000.

Reconciling the general ledger and stock control ledger involves a comparison of entries for the receipt of materials. Because of delays in clerical processing, transactions are recorded in different time periods in the two ledgers. At any given time, therefore, the balances of the two ledgers differ and are brought into agreement by accounting for reconciling items.

The ledgers also were not reconcilable because adjustments to allocated material balances recorded in the stock control ledger were recorded both as adjustments and as issues to jobs in the general ledger. Also there were no controls to assure that all adjustments recorded in the stock control ledger were recorded in the general ledger.

Considering the significant cost of station inventory, its nature and its relatively high turnover rate, we believe that the station should improve procedures relating to inventory controls. Accordingly, we recommend that physical inventories be taken on a regular cycle, procedures for correcting records be improved and efforts be intensified to reconcile general ledger with stock records.

ACCOUNTING FOR OVERHEAD COSTS

Our review disclosed that job orders were not equitably charged for overhead costs because the station (1) did not distribute to production cost centers the costs of some support-type services that they received, (2) arbitrarily limited the overhead rate applied to the Applied Research and Engineering (AR&E) Department, and (3) charged some Public Works (PW) Department salaries or wages both as direct labor and applied overhead. As a result of these actions, job orders of the affected cost centers were either over or undercharged.

Distributing Overhead Costs

In order to equitably charge job orders, a production overhead rate must be developed for each production cost center. To develop a reasonably accurate rate, the cost of support-type services provided by other cost centers should be distributed to production cost centers on the basis of services they receive.

Our review disclosed that the station did not distribute all support-services cost on the basis of benefits to using production cost centers. The cost of utilities and reproduction-blueprinting services were considered part of general overhead expense. This general expense was distributed to all production cost centers on the basis of direct labor hours. Similarly costs of tool crib operations and production planning were distributed on the basis of direct labor hours to several of the major production cost centers, but not to all cost centers to which applicable. We believe that these methods of distributing costs are not equitable, since the results could only coincidentally provide a reasonably accurate measurement of the cost of support-services received by each production cost center.

In our opinion, the foregoing overhead cost elements-utilities, reproduction-blueprinting, and tool crib are significant. They were estimated to be approximately $2 million, about 18 percent of the estimated $11.1 million overhead costs included in the fiscal year 1969 budget.

For fiscal year 1969, we compared the overhead rates developed under station procedures with rates based on services received by individual cost centers as shown by station studies. Our comparison showed that, considering the foregoing overhead elements, the Machining Branch overhead was overestimated by the largest amount, $94,200 (2.5 percent) and the AR and E Department overhead was underestimated by the largest amount, $99,000 (9.5 percent).

The following table shows for each of the foregoing overhead cost elements, the cost centers whose overhead were most significantly over and underestimated under station procedures for fiscal year 1969.

Overhead cost	Cost center	Most significant over-(under) estimate: Amount	Most significant over-(under) estimate: Percent of center overhead
Utilities	Machining	$40,500	1.1
	Quality assurance	(35,600)	(2.6)
Reproduction-blueprinting	AR & E	28,100	2.7
	Machining	(40,800)	(1.1)
Tool Crib	Electrical assembly	55,800	3.4
	Mechanical assembly	(65,500)	(3.9)
Production planning	Quality assurance	69,900	5.0
	Machining	(89,800)	(2.4)

In our comparisons we have considered the offsetting effects on general expense overhead when production expense overhead is increased or decreased.

We believe it is practicable, with relatively simple inexpensive accounting procedures, to improve distributions of overhead based on services received by production cost centers. The improved distributions might be made by using cost-finding techniques. For example, we found that tool crib personnel could be associated with services provided to the various cost centers. The cost of utilities usage could be distributed objectively on the basis of factors such as area occupied, number of employees, machines and air conditioning units. A simplifying factor in distributing utility costs is that about one-half of the cost is relatively fixed and does not fluctuate significantly with changes in production levels.

Some support-service costs may be more accurately distributed by maintaining basic usage records. For example, records can and have been maintained showing the cost of reproduction-blueprinting and of tool crib purchases provided to production cost centers.

The present methods result in distributions of overhead that bear only coincidental relationships to services received by users. We believe the foregoing cost-finding techniques would be more logical bases for distributing these costs and would result in more equitable charges to job orders with reimbursements from customers more in line with actual production costs.

Limiting AR and E Department Overhead

In our review of the fiscal year 1969 budget, we noted that job performed by the AR and E Department were undercharged because the station arbitrarily limited the AR and E production expense overhead rate. In estimating the fiscal year 1969 overhead rates, the station transferred about $166,100 AR and E Department estimated production expenses to a general expense cost center. We were informed that this was done to enable the Weapons Improvement Laboratory of the AR and E Department to compete for customers' orders, which was to the benefit of all station operations.

In our opinion, limiting overhead rates in order to be price competitive is contrary to the industrial fund objective of recovering the cost of products and services provided to customers.

Charging PW Department Wages

During fiscal year 1969 the wages of some PW Department employees were reclassified from indirect to direct labor. To give effect to this change, the Comptroller's Department should have (1) appropriately reduced the size of the overhead costs to be applied and (2) recognized a larger direct labor hours base used in applying overhead. Because the adjustments, called for by the reclassification of PW employees, were not made, the station over-applied overhead, which was billed to and collected from customers, in the amount of $538,000.

RECORDING EQUIPMENT ACQUISITIONS

Our review disclosed that station procedures did not provide for the prompt recording of equipment acquisitions. We found that 53 equipment items with an acquisition cost of $313,500 had not been recorded in the NIF accounting records as of June 30, 1969. About 23 of the unrecorded items had been received during 1968 and two during 1967.

The NAVCOMPT Manual (section 036203) states that recording equipment in financial records shall not be delayed for any reason, such as delays in installation, or the lack of complete cost data.

The Production Department was responsible for preparing and forwarding documentation to the Comptroller Division for recording into the NIF property accounts. Production Department personnel stated that they delayed submitting records to the Comptroller Division because it was too time-consuming to forward documentation prior to the installation of an item and later prepare documents on installation costs for additional posting. In view of the extensive delays involved in many instances, the equipment should be recorded upon receipt and property accountability established.

We believe that compliance with the NAVCOMPT Manual would contribute to sound administration of station property. We, therefore, believe that the significant amounts of unrecorded equipment should be brought under accounting control and procedures instituted to assure that future acquisitions are recorded in a timely manner.

CONTROLS OVER CASH RECEIPTS

Our review disclosed that the station's cash receipts procedures did not adequately provide for the prompt recording and deposit of all receipts and for segregating the duties of handling cash and maintaining cash records. Our review of cash receipts procedures was directed primarily to evaluating internal controls. We did not perform a detailed examination to verify cash balances.

The NAVCOMPT Manual (section 041500 and 042410.1) places restrictions as to which employees may be authorized to receive cash and requires that cash receipts be deposited daily when practical.

The Gage and Standards (G and S) Department has performed work for private industry on a reimbursable basis. We were informed that the G and S Department requested these customers to send their checks directly to the G and S Department. We found that the G and S Department did not record the receipt of the checks and held them, in unsecured desks, for varying lengths of time before forwarding them to the Deputy Disbursing Officer (DDO). Our review of 11 checks totaling about $1,200 sent to the DDO during July 1969, showed that five had been held by the G and S Department for over 20 days.

The General Accounting Branch received rental and utility payments of about $300 a month from tenants of a trailer court located on Station property. Our review showed that the same employees who received these payments were also responsible for maintaining the cash receipts and disbursements registers.

In our opinion, improvements in cash receipts procedures can be made without requiring elaborate or costly procedures. We, therefore, believe that procedures should be effected to correct the above weaknesses in internal control.

REPORTING OF OBLIGATIONS

The station is required by NAVORDINST 7600.7 to prepare monthly reports on obligations to enable the Treasury Department to project, in advance of disbursements, the effects of Federal Government transactions on the nation's economy. Also, the NIF Handbook (section 4110.2.c(7)) requires the station to report, as a footnote to financial statements, its contingent liability for unliquidated obligations.

We believe that the station should establish procedures to accurately report obligation information. Our review disclosed several patterns or errors in reporting unliquidated obligations. We found that procedures were not established to assure that obligations were recorded in the proper period. Also, the reports did not include unliquidated obligations for undelivered orders made under blanket purchase agreements. We believe undelivered orders could be included simply by preparing an adding machine tape of the amounts at the end of the month.

CLERICAL ERRORS

In addition to the procedural problem, we noted a considerable number of clerical errors occurring in the following areas.

The reconciliation of the general ledger and stock control ledger involves a matching of receipt documents used to make entries in the stock control ledger with payment documents used to make entries in the general ledger. We found many errors in this matching process, some relating to material received in 1967.

To determine the amount of unliquidated obligations at month-end, the station must reduce the balance shown on its list of outstanding obligations. This reduction required the matching of documents from the Supply and Comptroller Departments to determine which amounts included in the listing should be considered accounts payable. We found numerous errors in the document matching process which had the effect of misstating the month-end balance of unliquidated obligations. In addition, the station used the adjustment amount for the previous month to adjust the current month's balance.

It is our understanding from the closing interview with you and your Comptroller that you generally agree with our observations and plan to initiate appropriate improvements. We would appreciate any further comments you may wish to make regarding actions planned or taken concerning the above matters.

We wish to express our appreciation for the cooperation and assistance extended to our staff during this review.

Information copies of this letter will be furnished to the Assistant Secretary of the Navy (Financial Management) and to the Assistant Secretary of Defense (Comptroller).

Sincerely yours,

M. R. Wolfson

M. R. Wolfson
Regional Manager