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General Accounting Office

Navy Shipyard Accounting System Needs Improvement

The accounting system at the Long Beach and Pearl Harbor Naval Shipyards has not been implemented in full accordance with the system design for shipyards that GAO approved in June 1975. As a result, inventory values reported to Navy headquarters and the Congress were incorrect; accounts receivable were not properly shown on financial statements; and control over appropriated funds was inadequate.

GAO recommends that the Navy adjust the shipyard accounting system to conform with the approved system design.

FGMSD-79-34
JUNE 6, 1979

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

DIVISION OF FINANCIAL AND
GENERAL MANAGEMENT STUDIES

B-159797

The Honorable Harold Brown
The Secretary of Defense

Dear Mr. Secretary:

This report identifies weaknesses in the accounting system at the Long Beach and Pearl Harbor Naval Shipyards and the need for system improvements.

This report contains recommendations to you. As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of this report and to the House and Senate Committees on Appropriations with the Agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget and to the Secretary of the Navy. We are also sending copies to the Chairmen, House and Senate Committees on Appropriations, House and Senate Committees on Armed Services, House Committee on Government Operations, and Senate Committee on Governmental Affairs.

Sincerely yours,

D L Scantlebury

D. L. Scantlebury
Director

GENERAL ACCOUNTING OFFICE REPORT TO THE SECRETARY OF DEFENSE

NAVY SHIPYARD ACCOUNTING SYSTEM NEEDS IMPROVEMENT

D I G E S T

Bckgd.

The accounting system at the Long Beach and Pearl Harbor Naval Shipyards has not been implemented in full accordance with the documented standard system design for Navy shipyards ~~that GAO~~ which was approved in June 1975. As a result, inventory values reported to Navy headquarters and ~~the~~ Congress were incorrect; accounts receivable were not properly shown on financial statements; and control over appropriated funds was inadequate.

INADEQUATE ADMINISTRATIVE CONTROL OVER CUSTOMER FUNDS

The shipyards' administrative control over customer funds was not adequate to insure that (1) funds are used for only authorized purposes and (2) obligations and expenditures do not exceed the amounts authorized.

Specifically, GAO found that the shipyards:

→ Project orders were combined

--Combined project orders, thereby precluding the shipyards from matching expenditures incurred with funds received from the customer during the year.

--Did not exercise adequate controls to insure proper cost transfers between customer orders. were not exercised

--Used expired appropriations, were used in renegotiating fixed price orders.

Current operating procedures at the shipyards do not provide proper administrative control over funds. Further clarification and amplification of Navy instructions on fund control are necessary to ensure that the shipyards improve their system of management control over customer funds.

Tear Sheet. Upon removal, the report cover date should be noted hereon.

FGMSD-79-34

INVENTORY VALUES OVERSTATED

The material-in-transit account at both shipyards was overstated by over $1 million because improper transactions were recorded and remained in the account. For example, some of the disbursements were for transportation requests and had no relation to material assets.

The balance of the direct material inventory account was not accurate because the general ledger and the subsidiary records were not reconciled as required. For example, at one shipyard the direct material inventory general ledger account showed a balance of $7,443,000 and the subsidiary accounts showed a balance of $6,626,000. The difference was not reconciled or explained, and the higher figure was arbitrarily used in financial statements which were sent to top managers and the Congress.

ACCOUNTS RECEIVABLE ARE NOT REPORTED CORRECTLY

Although the approved system design requires the use of three separate accounts to classify accounts receivabe, the shipyards were using only one account. For example, one shipyard reported $393,590 as Accounts Receivable - Government, when $61,129 of the amount should have been reported as Accounts Receivable - Other.

RECOMMENDATIONS p.11

GAO is recommending that the Secretary of Defense direct the Secretary of the Navy to ensure that all shipyards have fully implemented the approved accounting system. GAO is making additional recommendations to improve the Navy's shipyard accounting system and administrative control over customer funds. (See p. 11.)

AGENCY COMMENTS

GAO informally discussed its findings with responsible Navy officials and their comments were considered in the preparation of the report.

Contents

CHAPTER 1

INTRODUCTION

The Budget and Accounting Procedures Act of 1950 requires the head of each agency to establish and maintain systems of internal control over and accountability for all funds, property, and other assets for which the agency is responsible. The act also requires agencies to conform their accounting systems to the accounting principles and standards prescribed by the Comptroller General. The act further requires that each agency head submit its accounting systems to the Comptroller General for approval.

We have established procedures for examining agency accounting systems which are submitted to the Comptroller General for approval. The systems are reviewed in two stages. First, we examine the accounting principles and standards established by the agency as the basis for its accounting system. Secondly, we review the documented accounting system design for conformance with the approved principles and standards.

The accounting principles and standards for all Navy organizations were approved in March 1973. The industrial fund system design for naval shipyards was approved by the Comptroller General in June 1975. The approval was based on a design package which included the Navy industrial Fund Handbook and the cost application segment of the Shipyard Management Information System. The Handbook is the basic document because it provides the accounting procedures to be followed by all shipyards.

The approval process ensures that the accounting system design includes the minimal procedures to help agency officials effectively manage and protect Government assets and funds and provide accurate information to the Congress and the public. Once an accounting system design has been approved, each agency is responsible for ensuring that the system which is implemented conforms to the approved system design. The Defense Audit Service and the military departments' audit services have been given the responsibility for auditing approved Defense systems to ensure that the systems in operation are in conformity with the approved design.

Naval shipyards are industrial fund installations whose primary functions are to construct, convert, modernize, overhaul, and repair U.S. Naval ships. The shipyards are subordinate to the Naval Sea Systems Command, and the accounting and budgeting is performed under the Navy Industrial Fund regulations, as specified by the Comptroller of the Navy.

The eight Naval shipyards are located at Philadelphia, Pennsylvania; Charleston, South Carolina; Norfolk, Virginia; Portsmouth, New Hampshire; Pearl Harbor, Hawaii; Long Beach, California; Puget Sound, Washington; and Mare Island, California. The shipyards' combined fiscal 1978 revenue from operations was over $1.4 billion. Long Beach and Pearl Harbor reported revenues of about $249 million and $192 million, respectively, in fiscal 1978.

An industrially funded organization receives orders from its customers for goods or services. Upon acceptance of an order by shipyards and other industrially funded organizations, the customers obligate their appropriations for the amount necessary to perform the work requested. This amount represents the maximum costs the shipyards are authorized to bill the customer for the performance of the work, unless both parties agree to a modification.

CHAPTER 2

ACCOUNTING SYSTEM HAS NOT BEEN IMPLEMENTED IN FULL ACCORDANCE WITH THE APPROVED SYSTEM DESIGN

The accounting system in operation at the Long Beach and Pearl Harbor Naval Shipyards has not been implemented in full accordance with the system design approved by the Comptroller General in June 1975. As a result,

--control over customers' appropriated funds was not adequate to ensure that they were properly used,

--the material-in-transit and direct materials were not properly accounted for, and

--accounts receivable were not reported correctly.

Because of these deficiencies, the financial statements prepared by the shipyards for Navy management and the Congress were not accurate, as described in detail below.

INADEQUATE ADMINISTRATIVE CONTROL OVER CUSTOMER FUNDS

The shipyards' control over customer funds was not adequate to ensure proper use of these funds. Specifically, we found that the shipyards:

--Combined project orders which precluded the shipyards from matching expenditures incurred with funds received from the customer during the year.

--Did not exercise adequate controls to insure proper cost transfers between customer orders.

--Used expired appropriations in renegotiating fixed price orders.

The Anti-Deficiency Act (31 U.S.C. 665(g)) requires each agency to have a system of control which will restrict obligations or expenditures to the amounts appropriated. To comply with this requirement each accounting system should provide information and controls to insure that (1) funds are used only for authorized purposes and (2) obligations and expenditures do not exceed the amounts authorized.

The Naval Industrial Fund Handbook requires that shipyard customers be responsible for the proper use of the appropriated funds made available to them. The Handbook further states that the shipyard is responsible for the administrative control of funds received from customers for the orders accepted. The shipyard is also responsible for insuring that proper use is made of the customer's appropriated funds.

Multiple year funding results in loss of administrative control over customer funds

The practice of combining two or more project orders financed by appropriations from different fiscal years into one project order results in the loss of administrative control over customer funds. As a result, the shipyards are not able to identify and reconcile incurred expenditures with funds that are received from the customer.

Navy Comptroller regulations require that each project order specify the exact nature of the work that will be performed under that order. For example, each project order should specify if it is for the manufacturer of materials, supplies, or equipment or for other work or services that will require appropriated funds. Further, project orders are analogous to contracts placed with a commercial enterprise; they should specify the work encompassed by the order.

The shipyards, however, under their multiple funding procedures, do not require that individual project orders be specific. For example, when planning for an overhaul begins, a project order that cites current funds is accepted, and preliminary work is begun. The scope of work in the overhaul has not as yet been outlined so the first project order cannot be "specific, definite, and certain." The scope of the overhaul is determined during the planning phase.

In subsequent fiscal years, new project orders are issued obligating then current funds which are added to the original funding. Work continues on the ongoing project with no separate determination of costs by individual project order. The new project orders are usually nonspecific in scope, using such general language as, "to increase the advance planning, overhaul, or alteration estimated." The scope of each individual project order is never specifically determined, and the annual appropriations are improperly commingled.

We reviewed project orders at the Long Beach and Pearl Harbor Shipyards and found that none specified the scope of work to be performed. Each project order refeired to the general overhaul of the vessel as the scope. Since the orders were not specific, funding from several different fiscal year appropriations was, in effect, combined, and the expenditures incurred by the shipyards during each fiscal year could not be matched to the funds authorized by the customer.

For example, in the overhaul of the USS Horne at the Long Beach Shipyard, four separate project orders citing four annual appropriations were issued. The overhaul was performed in fiscal 1974-77. The first project order was issued to accomplish advance planning efforts, which included ship inspection, design, and procurement of long lead-time material. Three subsequent project orders were issued to finance the overhaul. These orders did not cite the specific work to be performed, but merely stated that they were established to finance the overhaul. As shown in the following table, costs billed during each period were not matched to the funding authorized from that year's appropriation.

Year of appropriation	Funds obligated	Commingled cumulative funding	End of year cumulative expenditures
1974	300,000	300,000	49,308
1975	350,000	650,000	232,141
1976	950,000	1,600,000	478,309
1977	14,379,879	15,979,879	15,979,879

Since the scope of work to be performed was not specified, expenditures that were incurred could not be specifically identified to the appropriation obligated by the customer.

Inadequate controls over cost transfers between customer orders

The shipyards did not have adequate internal controls which could assure that cost transfers between customer orders were proper. Specifically, we observed instances in which cost transfers were

--made to preclude cost overruns,
--made before funding authorization, was received,
--not adequately justified and documented, and
--not properly approved.

Navy Comptroller Instruction 7600.21 dated September 5, 1975, states that costs can be transferred between customer orders only to correct an erroneous charge. In addition, the instruction requires that a specific individual be responsible for approving cost transfers. Also, the Naval Industrial Fund Handbook states that requests for work or services will be in the form of project orders, work requests, or other reimbursable orders. The acceptance of these orders is the basic source of authority for the shipyard to perform work and incur costs. Further, a shipyard official stated that work should not begin until an approved funding document is received.

Cost transfers made to preclude cost overruns

At the Pearl Harbor Shipyard, we found four cost transfers valued at $33,000 that were made between customer orders to preclude cost overruns. In each case, the charges were transferred to the subsequent year's customer order which was funded by a different annual appropriation.

The Navy Industrial Fund Handbook requires that each order be treated individually and prohibits costs from being combined with or transferred between orders. Making cost transfers to preclude overruns defeats the purpose of the cost accounting systems and, in the four cases cited, the transfers resulted in charging the wrong appropriations.

Shipwork started prior to receipt of funding

We found that, contrary to regulations, 68 transfers totaling about $274,000 were made between customer orders at the Long Beach Naval Shipyard to finance work before funding authorizations were received.

In May 1977, the Naval Sea Systems Command informed the shipyard of modifications required on three ships--USS Leahy, USS Horn, and USS Robinson. The Command indicated that planning estimates had been established and funds would be provided separately.

The funding authorization for the three ships was not received by the shipyard until July 1977. However, the modifications were started months earlier by using existing customer orders. The modifications had begun on two of the ships in February 1977 and on the third ship in June 1977--all before funding documents were received. In August and November 1977, costs of $28,332 were transferred to the appropriate customer order.

Transfers not properly approved or adequately documented

To help assure that cost transfers are proper, they should be properly approved and explained. This was not the case for 32 of the 36 transfers we reviewed.

Cost transfers should be approved by someone independent of the organization making the request for transfer. Our review at the Pearl Harbor Shipyard disclosed 32 transfers that were approved by the same individual who initiated the transfer request.

In addition, a Pearl Harbor instruction requires that to facilitate review and audit, all requests for transfer must be adequately explained, and supporting documentation must be retained by the shipyard. Of the 36 transfer documents we reviewed, only 4 were adequately documented. We traced most of the 36 transfers to the originators and found that, in general, supporting documentation was not retained.

Improper use of expired appropriations

Once an appropriation cited in a project order expires for obligational purposes, it cannot be used to increase the scope of work to be performed. Both the Pearl Harbor and Long Beach Shipyards used expired appropriations to renegotiate fixed-price customer orders.

The appropriation is available, however, for price increases that may occur. Naval Sea Systems Command Instruction 7600.1 states that fixed prices can be renegotiated when

--the customer requests a change in the scope of the work,

--the customer requests a change in the dates of the work performance, and

--work is required for damage resulting from acts of God.

The instruction further states that when additional work is accepted under a project order, it must always be funded by funds that are current as of that date.

At Pearl Harbor the overhaul of the USS Knox was covered in a July 1976 fixed-priced customer order for $1.6 million. In November 1976, the price was increased to about $2.1 million.

The project order amendments authorizing the funding increase cited the cost growth within the scope of the work as the justification. We reviewed the supporting documentation and found the increase was the result of new work and not due to cost growth. Since the increase occurred because of new work, fiscal 1977 funds should have been cited; however, fiscal 1976 funds were cited and used. Thus, the shipyard in effect used expired appropriations to finance the additional work.

In a review of fixed-price project orders and amendments at the Long Beach Shipyard, the Naval Audit Service found a similar situation. They found that fixed price increases of about $2.5 million had been improperly renegotiated using expired appropriations.

MATERIAL-IN-TRANSIT ACCOUNT OVERSTATED

The Navy Industrial Fund Handbook defines material-in-transit as material for which payment has been made pending actual receipt or acceptance. Both shipyards were reporting invalid transactions in the material-in-transit account. Further, Pearl Harbor was recording and reporting non-material transactions in the account. As a result, the account was significantly overstated.

At Long Beach, our analysis of 36 transactions disclosed that 30 transactions valued at $568,615 should not have been recorded in the account. For example, many of the transactions were for material that had already been received at the shipyard and, therefore, should not have been included in the reported account balance.

The Naval Audit Service reported that a similar condition existed at Pearl Harbor. The auditors reviewed 45 transactions valued at about $660,000 and found that 31 transactions valued at about $472,000 were improperly recorded in the account. Some of the transactions were for transportation requests and had no relationship to material assets.

We discussed this matter with Naval Sea Systems Command officials who stated that they realize that invalid and non-material transactions are processed in the account. They said the shipyards have been instructed to adjust the account at the end of each month for transactions which are not valid.

Although the Navy has taken action to improve the accuracy of the reported account balance, the internal controls approved in the system design have not been implemented. The Navy should ensure that these controls are implemented at all shipyards to ensure conformity with the approved system design.

DIRECT MATERIAL INVENTORY ACCOUNT NOT RECONCILED

Both the Long Beach and Pearl Harbor shipyards are required to make monthly and quarterly reconciliations of their direct material inventory account. Each shipyard's system produces a monthly report showing direct material inventory by ship hull number and in total. The report summarizes the subsidiary records of the shipyard and should be reconciled to the control account in the general ledger. However, the required reconciliation was not made and, therefore, the reported inventory balance was not accurate.

Our analysis of the direct material inventory revealed three violations of the reconciliation requirement:

--The monthly balance of the general ledger control account did not agree with the subsidiary accounts balance.

--The two balances are not reconciled.

--The subsidiary account balance is arbitrarily adjusted, for statement purposes, to agree with the general ledger.

At the Long Beach Shipyard, the September 30, 1977, Statement of Financial Condition reported that direct material inventory located on board ships was valued at about $7,443,000. For the same date, the subsidiary records indicated direct material inventory on ships to be about $6,626,000. Rather than determine the reasons for the difference, shipyard officials arbitrarily adjusted the subsidiary record total to agree with the general ledger.

We found a similar lack of reconciliation at Pearl Harbor. This matter was discussed with Naval Sea Systems Command officials, and they agreed the required reconciliations were not properly performed by the shipyards. The officials stated that this matter was discussed with the shipyards, and they have been instructed to perform the required reconciliations.

ACCOUNTS RECEIVABLE ARE NOT REPORTED CORRECTLY

The accounts receivable records maintained by the shipyards were not in accordance with the approved system design. The Handbook requires three accounts for receivables:

1310 Accounts Receivable - Government sources

1320 Accounts Receivable - Other sources

1330 Accounts Receivable - Credit pending from U.S. Government

Each shipyard, however, reported the balance of its accounts receivable on the financial statement as a single amount. For example, the December 31, 1977, financial statement for Long Beach showed Accounts Receivable - Government sources at $393,590. Our review of the subsidiary records disclosed, however, that the financial statement should have shown $332,461 in Accounts Receivable - Government sources and $61,129 Accounts Receivable - Other sources. We discussed this matter with shipyard officials and were informed that they have always reported receivables in this matter. The officials agreed to properly classify the accounts receivable balances in the future.

CONCLUSIONS

An approved system design provides the basic framework for agency heads to manage and control Government funds and assets. Agency heads must, however, make certain that approved system designs are properly implemented.

Although the Navy's shipyard accounting system design was approved in June 1975, it had not been fully implemented at the two locations we visited.

Current operating procedures at the shipyards do not provide proper administrative control over funds and afford opportunities for the misuse of annual appropriations. Opportunities exist to improve the control and administration of annual appropriations at naval shipyards and prevent recurrence of the situations reported. Further clarification and amplification of Navy instructions on fund control is necessary to ensure that the shipyards improve their system of management control.

RECOMMENDATIONS

We recommend that the Secretary of Defense direct the Secretary of the Navy to require the Long Beach and Pearl Harbor Shipyards to strengthen their controls over the use of appropriated funds and to review the transactions specifically identified in this report and make any appropriate adjustments.

We also recommend that the Secretary of Defense direct the Secretary of the Navy to establish procedures to ensure that all shipyards

--comply with Navy instructions and control procedures for project orders, fixed pricing, and cost reimbursable orders; and

--effectively implement Navy instructions on controls over cost transfers between customer orders.

We further recommend that the Secretary of Defense direct the Secretary of the Navy to ensure that the shipyard accounting system design approved by the Comptroller General is effectively implemented at all shipyards. In doing so, emphasis should be placed on

--eliminating the practice of recording and reporting improper transactions in the material-in-transit account,

--insuring that general ledger and subsidiary direct material inventory accounts are properly reconciled, and

--properly classifying accounts receivable on financial statements.

AGENCY COMMENTS

We discussed our findings informally with responsible Navy officials and their comments were considered in preparing the report.

CHAPTER 3

SCOPE OF REVIEW

We reviewed the accounting system in operation and the control over appropriated funds at the Long Beach and Pearl Harbor Naval Shipyards. Our review was directed primarily at determining whether the Navy had implemented the accounting system design for shipyards that the Comptroller General approved in June 1975.

Our review included an examination of policies, procedures, documents, and transactions. We interviewed responsible officials to discuss policies, procedures, and the results of our examination.

We made our review at the following Naval activities:

--Office of the Comptroller of the Navy
Washington, D.C.

--Naval Sea Systems Command
Washington, D.C.

--Long Beach Naval Shipyard
Long Beach, California.

--Pearl Harbor Naval Shipyard
Honolulu, Hawaii.

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