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BY THE COMPTROLLER GENERAL

Report To The Congress

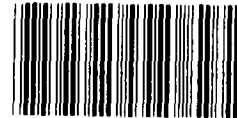
OF THE UNITED STATES

Millions In Stock Funds Mismanaged At Defense Personnel Support Center

The Defense Personnel Support Center, a major Department of Defense supply center, lost control of hundreds of millions of dollars in stock funds. The Center made adjustments of about \$566 million in an attempt to correct its financial records but the validity of most of these adjustments could not be determined because of inadequate documentation.

Fiscal 1978 and 1979 accounts were certified as correct by officials at the Center and the Defense Logistics Agency despite their knowledge of the Center's financial problems. These certifications may have violated the law.

The Center's funds control problems occurred because its accounting systems were ineffective. GAO recommends that Defense develop an overall plan for resolving the Center's problems and take other measures to strengthen financial operations.



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NOVEMBER 21, 1980

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-197559

To the President of the Senate and the
Speaker of the House of Representatives

DLB 05560

This report addresses the inability of the Defense Personnel Support Center to control hundreds of millions of stock fund dollars because of ineffective accounting systems.

We are sending copies of this report to the Director of the Office of Management and Budget and to the Secretary of Defense.

A handwritten signature in cursive script that reads "Luther B. Starks".

Comptroller General
of the United States

D I G E S T

The Defense Personnel Support Center, a major Department of Defense supply center which manages a multibillion dollar operation, lost control of hundreds of millions of dollars in stock funds. The Center could not accurately determine amounts paid and amounts of unliquidated obligations. In an attempt to correct its records, the Center made financial adjustments of about \$566 million during fiscal 1978 and 1979. However, the validity of most of these adjustments could not be determined because they were not supported by adequate documentation. Even after the adjustments, GAO found that many of the Center's records were still inaccurate. (See p. 4.)

The chaotic condition of the Center's funds control systems and records prevented it from systematically detecting fraudulent contract payments, and fraudulent payments of \$794,101 were processed. The fraud was detected only because of a clerical error. (See p. 18.)

The Center's problems were compounded when erroneous account balances were certified as correct. The balances were certified even though the Center was aware that it had serious funds control problems. In addition, full disclosure was not made in financial statements of either the Center's funds control problems or the large amount of adjustments made without adequate supporting documentation. (See p. 5.)

The Defense Logistics Agency was aware of the Center's problems but did not require withdrawal or adequate qualification of certification statements. The Agency also certified the Center's accounts as correct despite knowledge of the Center's problems

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and unsupported adjustments. The certifications were accepted and relied upon by Department of Defense officials in preparing consolidated annual reports to the President and the Congress on the condition and operations of all Department of Defense working capital funds. (See p. 16.)

The fiscal 1978 and 1979 certifications may have violated 18 U.S.C. 1018, which makes it a crime for a person or public officer who is authorized by law to make or give a certificate, to knowingly make and deliver as true a certificate containing any statement known to be false. Defense needs to determine if the Center and/or the Defense Logistics Agency officials made certifications which they knew to be false within the terms of 18 U.S.C. 1018.

The Center's funds control problems occurred because its two major commodities are managed under ineffective financial accounting systems. The systems lack adequate controls to assure timely, accurate processing and recording of financial transactions. These systems have not been submitted to the Comptroller General for approval as required by law. (See p. 20.)

The financial subsystem of the Defense Logistics Agency's standard automated materiel management system was approved by the Comptroller General in 1973 but the conversion of the local systems to the standard management system has been delayed for several years. Task groups are now converting local systems but conversions will not eliminate the Center's financial problems unless the vast amount of inaccurate data is deleted from its records and operational problems are corrected. (See p. 21.)

The Center's operational problems included problems in funds control system procedures, practices, and documentation. Required reviews and reconciliations were not performed, rejected financial transactions were not always corrected promptly, personnel were not adequately trained, documentation supporting financial transactions could not be located or was incomplete, and written

operating procedures and instructions did not exist or were outdated. The Center attempted to correct some of its problems, but GAO's review showed that many problems still exist. (See p. 20.)

The Center's attempts to identify and correct its problems have been fragmented and guided by no overall plan. GAO believes a project management approach is needed. (See p. 27.)

GAO recommends that the Secretary of Defense investigate the fiscal 1978 and 1979 certificates submitted by the Center and the Defense Logistics Agency to determine if they were made when known to be false--which would be in violation of 18 U.S.C. 1018. If a violation has occurred, the Justice Department should be informed.

GAO also recommends that the Secretary of Defense have the Director, Defense Logistics Agency

- establish a project team to develop an overall plan for resolving the Defense Personnel Support Center's funds control problems;
- closely monitor and submit progress reports on the full implementation of the Defense Logistics Agency's standard automated materiel management system at the Defense Personnel Support Center to ensure that milestone dates for the various conversion phases are met;
- ensure that the Defense Personnel Support Center strengthens its reconciliation and validation procedures, improves its practices for correcting rejected financial transactions, provides adequate training to its personnel, improves its record-keeping, and prepares written procedures and instructions for operating its funds control system;
- ensure that the Defense Personnel Support Center's financial control account balances are reconciled with supporting records, and that amounts recorded in supporting

records are validated before the financial data is incorporated into the standard automated materiel management system; and

--ensure that the Defense Personnel Support Center's future reports of financial condition are qualified as necessary.

Furthermore, because of the seriousness of the Defense Personnel Support Center's problems, GAO recommends that, before the fiscal 1982 appropriations hearings, the Secretary of Defense provide an overall plan to the Chairmen of the House and Senate Committees on Appropriations defining the Center's funds control problems and their causes, specifying corrective actions and milestones for implementing the actions, and specifying the criteria to measure the effectiveness of actions taken.

AGENCY COMMENTS

In an August 27, 1980, letter (see app. IX), the Department of Defense concurred with GAO's recommendations. Further, Defense advised that a project team headed by a high level official had already been formed to develop an overall plan for resolving the Center's financial management problems.

Although agreeing that serious problems have been encountered at the Center for several years, Defense contended that the account balances certified had been validated through the use of statistical sampling techniques. Since most of the records that were to be included in the Center's sample were missing, GAO believes the results of the sample could not be relied upon in certifying account balances. However, even the limited results of the Center's sample required adjustments of hundreds of millions of dollars--indicating continued serious inaccuracies in the account balances. Further, GAO's sample of the unliquidated obligation account balances showed that many balances continued to be erroneously recorded at the end of fiscal 1979. Defense's comments on this and other issues are included throughout the report.

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CHAPTER 1

INTRODUCTION

DEFENSE LOGISTICS AGENCY

The Defense Logistics Agency, a worldwide military logistics organization, is responsible to the Secretary of Defense for providing services and supplies used in common by all the military services. The Agency's responsibilities include the acquisition, storage, and distribution of nearly two million consumable supply items and repair parts. The Agency operates six supply centers, seven supply depots, six logistics services centers, and nine Defense Contract Administration Services regions.

DEFENSE PERSONNEL SUPPORT CENTER

The Defense Personnel Support Center in Philadelphia, Pa., is the second largest of the Defense Logistics Agency's six supply centers. It is responsible for the procurement and supply management of more than 42,000 subsistence, medical, and clothing and textile items used by its customers which include the military services, some Federal civil agencies, and authorized foreign governments.

The Center manages a multibillion-dollar operation. The following schedule shows the amount of obligation authority allotted to the Center to accomplish program objectives. It also shows reported amounts of obligations and disbursements for fiscal 1977 through 1979, as well as reported amounts of unliquidated obligations at the end of the three fiscal years.

	<u>Fiscal years</u>		
	<u>1977</u>	<u>1978</u>	<u>1979</u>
	----- (millions) -----		
Obligation authority	\$2,060.0	\$2,131.3	\$2,273.0
Obligations	1,961.0	2,088.9	2,188.3
Disbursements	1,901.9	1,894.1	2,125.1
Unliquidated obligations	851.5	1,124.3	1,090.1

An obligation is a valid charge during a given period as a result of an order placed, contract awarded, services received, and similar transactions, which requires disbursements in accordance with the specified conditions. An unliquidated obligation is that portion of an obligation for which disbursements have not been made.

DEFENSE STOCK FUND

The three commodities managed by the Center are financed by the Defense Logistics Agency's stock fund which was established in accordance with the authority contained in the National Security Act of 1947, as amended (10 U.S.C. 2208). The stock fund provides the working capital to finance the procurement of materiel required by customers who must pay for the materiel they receive. Reimbursements from customers replenish the stock fund, which provides the working capital to finance the replacement of the inventory.

The Defense Logistics Agency is responsible for the overall administration and management of its stock fund. It authorizes each of its supply centers to obligate allotted procurement funds to meet approved program objectives. Each center is responsible for controlling both the amounts and the timing of procurement obligations for the various categories of materiel they manage.

A supply center's comptroller has primary responsibility for the activity's funds control system. Even though transactions committing and obligating procurement funds are initiated under other operational systems, the comptroller must account for and report on the use of all allotted stock funds. Two major functions of the funds control system are processing and recording of fund-type transactions, such as commitments, obligations, and expenditures, and maintaining the integrity of subsidiary records which support financial account balances.

The term funds control refers to management control of fund authorizations. It insures that funds are used economically and efficiently and only for authorized purposes, and that obligations and expenditures do not exceed the amounts authorized. Accounting systems must incorporate techniques to help achieve funds control.

PREVIOUSLY IDENTIFIED FUNDS CONTROL PROBLEMS

For several years the Center was aware that it had accounting system and funds control problems. These problems became more widely known in 1977 after it was disclosed that fraudulent contract payments had been processed.

In October 1977, the Defense Audit Service initiated a review of the Center's administrative control of funds. The review was made during the period October 1977 to June 1978 and the results reported to the Assistant Secretary of

Defense (Comptroller) in January 1979. The review disclosed the following deficiencies related to the control of stock funds:

- Required reviews and reconciliations were not performed to validate recorded unliquidated obligations.
- The amount of unpaid obligations certified as accurate at the end of fiscal 1977 and reported to higher authority was about \$324 million less than the amount recorded in the subsidiary accounting records.
- Internal controls over the processing of transactions were inadequate to prevent or disclose erroneous or fraudulent payments.
- Unsupported or improper adjustments were made to accounting records, and supporting documentation files were incomplete or could not be readily identified or located.
- Significant backlogs of unprocessed transactions existed.
- Written procedures for processing obligation and expenditure transactions either did not exist, were outdated, or were not being used by operating personnel.
- Undistributed disbursements were not reconciled.

Both the Center and the Defense Logistics Agency agreed that deficiencies existed as reported and promised to take corrective actions. As discussed in this report, the corrective actions taken by the Center have not yet eliminated its funds control problems. These actions are discussed throughout the report.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was designed to evaluate the effectiveness of the Defense Personnel Support Center's financial management and administrative control over its funds. Additionally, we were interested in assessing the corrective actions taken at the Center and the Defense Logistics Agency in response to the Defense Audit Services' recommendations.

Summarized briefly, our examination procedures involved reviewing (1) the Center's financial data, (2) appropriate legislation, (3) funds control procedures at the Center, and (4) correspondence regarding funds control problems. (See ch. 5, Scope of Review, for details.)

CHAPTER 2

LOSS OF CONTROL OVER HUNDREDS

OF MILLIONS OF DOLLARS

IN STOCK FUNDS

The Defense Personnel Support Center lost control of hundreds of millions of dollars of its stock funds. The Center could not accurately determine amounts paid and amounts of unliquidated obligations. In addition, erroneous balances of unliquidated obligations were certified as correct and reported by the Center to the Defense Logistics Agency at the end of fiscal 1977, 1978, and 1979. The certifications were made although the Center had not validated the reported amounts and knew that it had serious funds control problems. The fiscal 1978 and 1979 certificates may have been made in violation of 18 U.S.C. 1018, which makes it a crime to make or give a certificate known to be false.

The Defense Logistics Agency was also aware of the Center's problems but did not require it to withdraw or modify its certifications. The Agency also certified the Center's account balances as correct. The certifications were accepted and relied upon by Department of Defense officials in preparing annual consolidated reports to the President and the Congress on the condition and operations of all Department of Defense working capital funds.

In an attempt to correct its records, the Center made financial adjustments of about \$566 million during fiscal 1978 and 1979. Most of the adjustments were not supported by adequate documentation and we could not determine whether they were appropriate. In addition, the adjustments were not fully disclosed by the Center in its statements of stock fund condition submitted to the Defense Logistics Agency. Even after these adjustments, we found that many of the records were still inaccurate.

The chaotic condition of its funds control system and records precluded the Center from systematically preventing or detecting fraudulent contract payments, and fraudulent payments of \$794,101 were processed under two of its contracts. The fraud was detected only because of a clerical error.

RESPONSIBILITIES FOR RECORDING AND REPORTING FINANCIAL DATA

Section 1311 of the Supplemental Appropriations Act, 1955 (31 U.S.C. 200), establishes criteria for recording and

reporting obligations. The act provides that no amount shall be recorded as an obligation of the Government of the United States unless it is supported by documentary evidence of a binding agreement in writing between the parties thereto.

The act also provides that the head of each agency shall report, in connection with the submission of all requests for appropriations, that any statement of obligation furnished therewith consists of valid obligations. It also requires that each report be certified by the officials designated by the agency head, and the certifications shall be supported by records showing the amounts that are reported as obligated.

No penalty is prescribed for violating the requirements of 31 U.S.C. 200. However, section 1018 of title 18, United States Code, does prescribe penalties concerning official certificates or writings.

"Whoever, being a public officer or other person authorized by any law of the United States to make or give a certificate or other writing, knowingly makes and delivers as true such a certificate or writing, containing any statement which he knows to be false, in a case where the punishment thereof is not elsewhere expressly provided by law, shall be fined not more than \$500 or imprisoned more than one year, or both."

The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66, 66a) places the responsibility for full disclosure of Government financial operations upon the head of each executive agency. Disclosure is the communication of information on financial status, flow of funds, and financial results of operations relating to the activities conducted and funds administered by an agency. Achievement of fair presentation through full disclosure in financial reports requires that all financial data presented shall be accurate, reliable, and truthful.

INACCURATE BALANCES RECORDED
AND INADEQUATELY SUPPORTED
ADJUSTMENTS MADE

Hundreds of millions of dollars of stock fund balances that the Center had obligated were inaccurately recorded in the accounting system records. The Center was unable to accurately determine amounts paid and amounts of unliquidated obligations. Despite the loss of accountability, the Center certified the accuracy of unliquidated obligation balances reported to the Defense Logistics Agency at the end of fiscal 1977, 1978, and 1979. The amounts were certified as correct even though they had not been validated and the Center knew

there were serious funds control problems. The Agency also certified the Center's account balances despite its knowledge of the Center's problems.

In an attempt to correct its records, the Center made adjustments of \$566.5 million during fiscal 1978 and 1979. The adjustments were made to the Center's funds control accounts and to the subsidiary records which should contain the detailed support for the control account balances. Most of the adjustments, however, were not supported by adequate documentation and we could not determine if they were appropriate. Even after these adjustments, we found that many of the records were still inaccurate.

The Center did not fully disclose the amount of and basis for the adjustments nor the reasons for making them in its annual certified statements of stock fund condition submitted to the Defense Logistics Agency. We believe the adjustments were material and should have been fully disclosed to indicate the serious problems at the Center.

The following table shows the adjustments made by the Center during fiscal 1978 and 1979.

<u>Type of adjustments</u>	<u>Amount (millions)</u>
<u>Fiscal 1978</u>	
Adjustments to supporting accounting records	\$184.6
Yearend adjustments to funds control accounts	118.8
<u>Fiscal 1979</u>	
Adjustments to supporting accounting records	169.1
Yearend adjustments to funds control accounts	<u>94.0</u>
Total	<u>\$566.5</u>

The following sections discuss the recording, certifying, and reporting of erroneous unliquidated obligation balances for fiscal 1977, 1978, and 1979, and the inadequately supported and disclosed adjustments to financial records made during fiscal 1978 and 1979 in an attempt to correct the records.

Fiscal 1977

Amounts of unliquidated obligations reported by the Center at the end of fiscal 1977 were not validated before they were certified as accurate. Certified amounts were \$323.8 million less than the \$1,175.3 million recorded in subsidiary accounting records which should contain detailed support for the certified amounts.

Fiscal 1978

At the end of fiscal 1978, the Center certified as accurate unliquidated obligations balances that had not been validated and were erroneous. The inaccurate amounts were certified after the Center made financial adjustments of \$303.4 million during the fiscal year in an attempt to correct its records.

Adjustments of \$184.6 million were made to subsidiary accounting records, and yearend adjustments of \$118.8 million were made to funds control accounts. Most of the adjustments were not adequately supported by documentation. In addition, the adjustments were not fully disclosed to the Defense Logistics Agency.

Inaccurate balances recorded

In order to determine the validity of its records, the Center estimated the accuracy of unliquidated obligations of less than \$500,000 recorded in subsidiary records as of July 31, 1978, for perishable subsistence, medical, and clothing and textile items. The estimates were derived using statistical sampling methods. The following compares, by commodity, the total recorded amount of unliquidated obligations and the Center's estimate of total amounts that should have been recorded.

<u>Commodity</u>	<u>Total amount recorded</u>	<u>Estimated total amount</u> <u>(note a)</u>	<u>Possible sampling error</u>
Perishable subsistence	\$186,262,000	\$ 68,982,000	+ \$13,160,000
Medical	152,387,000	123,395,000	+ 6,712,000
Clothing and textile	139,966,000	114,985,000	+ 19,573,000

a/At the 95-percent level of statistical confidence.

The estimates indicate with reasonable certainty that there were errors in recorded amounts, especially for perishable subsistence items.

Despite knowing that many of its subsidiary records were inaccurate, the Center certified as accurate the unliquidated obligations balances recorded in the subsidiary records at the end of fiscal 1978. The certified balances were not validated.

Inadequately supported
subsidiary records adjustments

In July 1978, a task group established by the Center's comptroller began reviewing the validity of unliquidated obligations recorded in subsidiary records. Based on three reviews of unliquidated obligations in fiscal 1978, adjustments were made to subsidiary records reducing the unliquidated obligations by \$184.6 million. The adjustments also revised the balances in the funds control accounts. Adjustments of \$135.5 million made on the basis of one of these reviews were not adequately supported. Additional adjustments of \$49.1 million were adequately supported.

The adjustments of \$135.5 million were based on a comparison of amounts for subsistence items recorded in the Center's subsidiary records with amounts recorded for the same items by the Defense Contract Administration Services. When one of the Services' offices is designated as the administration/paying office for a contract, it establishes a record to control obligation and payment transactions. When the Center's comparison identified differences between the two agencies' records, an assumption was made that the Services' records were accurate, and the Center adjusted its records accordingly.

Prior to making adjustments, the Center did not validate the amounts recorded in the Services' records. In our January 9, 1980, report, "Defense Accounting For Its Contracts Has Too Many Errors--Standardized Accounting Procedures Are Needed" (FGMSD-80-10), we stated that the Contract Administration Services' contract accounting records contained errors. Reviewing 856 transactions recorded by the Services' regions, we identified 286 transactions with over \$90 million of accounting errors.

In a memorandum dated June 18, 1978, the chief of the Defense Logistics Agency's accounting and finance division told the Center's comptroller that amounts recorded in the Center's records could be considered valid if they matched amounts recorded in the Contract Administration Services' records. It was further stated, however, that differences between the two

agencies' records had to be investigated, and the Center was not authorized to automatically make adjustments to its records to conform to the Services' records.

The Center's unliquidated obligations were reduced by \$135.5 million based on the comparison of the two agencies' records. In fiscal 1979, the Center determined that adjustments eliminating unliquidated obligations for some items should not have been made. Expenditure or obligation adjustment transactions of \$2.9 million were subsequently recorded for these items although the records showed no unliquidated obligation balances.

In an August 27, 1980, letter (app. IX) commenting on this report, the Department of Defense disagreed with our conclusion that the \$135.5 million of adjustments were not validated and were unsupported.

Defense commented that the guidance in the June 18, 1978, memorandum was subsequently modified via telephone for subsistence only and where there were differences between the Center's and the Services' records, the Center was authorized to adjust its records to agree with the Services'. The action was taken because there were "* * * inadequate tools available to conduct a review and validation of line items DCASR [Defense Contract Administration Services regions] paid records." Also, the Services' "* * * records were taken to be an accurate reflection of the true unliquidated obligation balances." Additional reasons stated for this action were the "* * * press of time in which to validate the unliquidated obligations, the personnel availability and the magnitude of the task."

The Center is responsible for maintaining the official accounting records and for the proper accounting for the financial and other resources entrusted to it. The Contract Administration Services merely act as agents in managing the contracts and maintain records to preclude overdisbursements on contracts. Accordingly, the Services are not concerned with the validity of unliquidated obligations recorded in the Center's subsidiary records. The Center's records should not have been forced to agree with the Services' records; the discrepancies should have been investigated.

Inadequately supported
yearend adjustments

At the end of fiscal 1978, the Center made adjustments totaling \$118.8 million to its funds control accounts that were not adequately supported. Adjustments of \$68.8 million were

recorded to make the unliquidated obligation control accounts for each of the three commodities agree with the balances recorded in subsidiary records. An adjustment of \$50 million was also made to revise the balance in the undistributed disbursements account for the medical commodity.

At the end of fiscal 1978, the unliquidated obligations balances recorded in the funds control accounts for each of the center's three commodities were \$68.8 million less than the total balances recorded in the subsidiary records. Center personnel made the assumption that the total balances recorded in the subsidiary records were correct, and certified these balances as accurate. The Center had no firm basis for this assumption because the balances had not been validated.

At the end of fiscal 1978, there was a negative balance of \$275,659 in the undistributed disbursements 1/ account for the medical commodity. Based on an analysis of recorded amounts of unliquidated obligations and disbursements since the end of fiscal 1974, a positive account balance of \$49.7 million was derived, or a difference of \$50 million from the recorded negative balance. Adjustments were made to revise the account balance to the derived amount, and to revise three other account balances. The Center did not attempt to validate the adjusted account balance because at that time a required reconciliation was not made.

Fiscal 1979

At the end of fiscal 1979, the Center reported and certified as accurate, without validation, amounts of unliquidated obligations for each of its three commodities. The certified amounts were the total of the balances recorded in subsidiary accounting records. Our review of balances recorded in subsidiary records as of September 30, 1979, showed that many of the balances were erroneous.

The certifications were made after the Center made financial adjustments of \$263.1 million in an attempt to correct its records. Adjustments of \$169.1 million were made to subsidiary records, and a yearend adjustment of \$94 million was made to the subsistence commodity's accounts payable control account. Most of the adjustments were not adequately supported. In addition, the adjustments were not fully disclosed in certified reports.

1/Undistributed disbursements are payments that have not as yet been recorded as expenditures in the stock fund accounting records.

Inaccurate balances recorded

The Center certified as accurate unliquidated obligation balances of \$1,090.1 million recorded in subsidiary records at the end of fiscal 1979. Certifications were made without validating the accuracy of the balances.

To determine whether unliquidated obligations balances recorded in the subsidiary records at the end of fiscal 1979 were accurate, we reviewed the validity of selected balances for each of the Center's three commodities that were more than 120 days old as of September 30, 1979. We used statistical sampling methods to select the balances we reviewed. (See p. 33.)

We limited our review to balances more than 120 days old to be consistent with a Defense Logistics Agency regulation which states that its supply activities do not normally need to validate balances that are 120 days old or less. In our review, we relied on documentation available at the Center. In many instances, however, we encountered problems in determining whether payments were made and had to obtain supplemental information from the Defense Contract Administration Services' regional offices.

We used the results of our review of selected balances to estimate the accuracy of unliquidated obligation balances more than 120 days old recorded in the Center's subsidiary records as of September 30, 1979. Table 1 compares, by commodity, the number of recorded balances with our estimate of the number of balances that were inaccurately recorded.

Table 1

<u>Commodity</u>	<u>Number of balances recorded</u>	<u>Estimated number of inaccurately recorded records</u>	<u>Possible sampling error</u>
Subsistence	43,438	37,120	+ 4,540
Clothing and textile	27,983	8,650	+ 3,340
Medical	19,407	3,810	+ 2,130

Table 2 (on the next page) compares the total net amount of recorded unliquidated obligations with our estimate of the erroneous net amount recorded.

Table 2

<u>Commodity</u>	<u>Total net amount recorded</u>	<u>Estimated erroneous net amount recorded</u>	<u>Possible sampling errors</u>
Subsistence	\$100,261,974	\$52,033,000	+ \$30,243,700
Clothing and textile	295,460,672	29,608,100	+ 11,719,500
Medical	89,982,911	14,201,400	+ 18,861,100

The results of our review indicate with a high degree of assurance 1/ that many balances for each of the three commodities continue to be erroneously recorded at the end of fiscal 1979. The results also indicate, with the same degree of assurance, that the total dollar amounts of recorded balances for subsistence and clothing and textile items are also inaccurate. We cannot, however, conclude that the dollar amount for medical items differs from the recorded total amount because some recorded balances were greater than they should have been, while others were less than they should have been, and the differences tended to offset each other.

Inadequately supported subsidiary records adjustments

During fiscal 1979, the comptroller's task group made 12 reviews of unliquidated obligations balances recorded in subsidiary records. As a result, the Center made adjustments by reducing the amount of recorded unliquidated obligations by \$169.1 million. The adjustments also revised balances in funds control accounts. Many of the adjustments were not supported by adequate documentation. In 11 of the 12 reviews, the task group had difficulty documenting the validity of the balances selected for detailed examination. (See app. I.)

Included in the scope of 10 of the task group's 11 reviews were records with 60,934 unliquidated obligation balances. Of these records, 6,146 balances were selected for detailed review, but adequate documentation could not be found or readily located to validate 4,496 of the balances, or 73 percent. In the eleventh review, the task group stated that complete documentation was not available to fully review all the unliquidated obligations, but did not say how many of the records selected lacked adequate documentation. Where adequate documentation was available the task group identified only four valid unliquidated obligation amounts.

1/Estimates were computed at the 90-percent level of statistical confidence.

Because of inadequate documentation, some assumptions were made concerning the validity of unliquidated obligations. The following are examples of cases where documentation to validate recorded amounts could not be located for large numbers of records, and the decision to liquidate amounts of unliquidated obligations was based on an assumption.

--As of March 31, 1979, records showed over 13,000 purchases of fresh fruit and vegetable items prior to January 1, 1979. The recorded unliquidated obligations for these items totaled about \$25 million. The task group selected 2,901 records for detailed examination, but could not document 2,400, or 83 percent. Based on the review of the remaining 501 documented records and the assumption that vendors should normally be paid within 90 days of the contract award date, a decision was made to record expenditure transactions to eliminate the entire \$25 million of unliquidated obligations.

--In September 1979, about 5,500 records showed procurement of a group of brand name subsistence items with unliquidated obligations totaling about \$5.2 million. The task group reviewed about 1,350 of the records and found that the procured goods had been delivered more than 11 months before the review. Although payment vouchers could not be found for any of the 1,350 records, an assumption was made that all vendors were paid because of the time interval since receipt of the goods. Accordingly, expenditure transactions were recorded to liquidate all 5,500 records.

Inadequately supported yearend
adjustment

At the end of fiscal 1979, the balance in the subsistence commodity's funds control accounts payable account 1/ was \$2.5 million. The Center estimated that the account balance should be \$96.5 million, and made an adjustment of \$94 million to increase the balance. The revised accounts payable balance was not supported, however, by the subsidiary records which totaled \$547.9 million for subsistence items at the end of fiscal 1979. The account balance should be supported by amounts recorded in subsidiary records. The large disparity between the amounts indicates that the Center lost control of accounts payable.

1/Accounts payable are amounts due for goods or services received from all sources.

Inadequate disclosure of adjustments

In the Center's fiscal 1978 certified statement of stock fund condition for the subsistence commodity, a comment was made that the various balances of unliquidated subsistence obligations on the records of the Defense Contract Administration Services regions were used to replace balances recorded in the Center's financial system. The dollar amount of the adjustments made as a result of this action, the reasons for making them, and the reason for the lack of validation were not disclosed. In addition, the yearend correcting adjustments to the funds control account balances were not disclosed.

In October 1979, the Center's comptroller submitted an annual certified statement of stock fund condition to the Defense Logistics Agency for each of the three commodities managed. The statements contained no information on the adjustments made to the Center's subsidiary records and the subsistence accounts payable account.

During our review we had frequently suggested to Center officials that the fiscal 1979 certification be qualified. Subsequently, on November 21, 1979, the Center's comptroller sent a memorandum to the Agency stating that the certified statements should include two disclosure notes. (See app. VIII.)

The first disclosure note concerned the

"* * *full disclosure of the treatment of unliquidated and obligation records in the Defense Subsistence, Medical, and Clothing and Textiles Stock Fund Financial Statements and analysis reports for the year ending 30 September 1979."

The note gives the number of subsidiary records adjusted during fiscal 1979. It also gives the Center's justification for eliminating the records from the files.

"Had we [the Center] not taken the actions to eliminate these records, they would have undoubtedly remained in our computer files with unliquidated values indefinitely. The findings in each of our reviews indicated that subsidiary records of unliquidated obligations did not accurately reflect true balances. It is not reasonable to expect that these records could have been corrected as a result of individual record by record unliquidated obligation reviews. In addition to the magnitude of the manpower resources required, the lack of adequate documentation and transaction history records would have made such an effort impossible."

Although the above justification recognizes the number of records eliminated, it does not indicate the dollar amount of these records nor the funds control problems that made the adjustments necessary.

The second disclosure note indicated that a \$94 million adjustment had been made to the subsistence accounts payable. However, the note did not disclose that the revised account balance was not supported by amounts recorded in subsidiary records.

In commenting on this issue, the Department of Defense stated:

"There is no definitive guidance concerning disclosure statements in financial statements. During the last few years there has been much printed in professional publications and cases in courts concerning appropriate disclosure in financial statements. However, disclosure statements are still a matter of professional judgment. DPSC [Defense Personnel Support Center] made adjustments which they considered appropriate. The financial statements for fiscal years 1978 and 1979 were substantially correct in the view of DLA [Defense Personnel Logistics Agency] and further disclosure statements did not appear necessary when the 1978 and 1979 financial statements were prepared and submitted."

While we recognize that the use of disclosure statements is not definitive and requires a professional judgment, we believe that the situation at the Center warranted disclosure for the following reasons:

- Large discrepancies existed between the general ledger accounts and subsidiary accounts.
- Unusual procedures were used to determine account balances, such as using Defense Contract Administration Services records.
- Hundreds of millions of dollars in adjustments were recorded.
- Systems problems have continued.

The Center recognized that these problems warranted disclosure and attempted to file a disclosure statement after the fiscal 1979 certification. Because of the magnitude of the Center's problems, we believe this disclosure was warranted and should have been forwarded to Defense. Also, we believe the fiscal 1978 certification should have included a disclosure statement.

POTENTIAL VIOLATIONS OF
OFFICIAL CERTIFICATION STATUTE

In certifying the fiscal 1978 and 1979 accounts as correct, Defense Logistics Agency and Center certifying officials may have violated the official certificates or writings statute (18 U.S.C. 1018). While 31 U.S.C. 200 prescribes no penalties, 18 U.S.C. 1018 makes it a crime (punishable by a fine of not more than \$500 or imprisonment for not more than one year or both) for a person or public officer who is authorized by law to make or give a certificate, to knowingly make and deliver as true a certificate containing any statement he knows to be false. Defense needs to investigate the certifications to determine if they were made when known to be false, within the terms of 18 U.S.C. 1018.

Fiscal 1978 certification

During fiscal 1978, Center officials approved over \$300 million in adjustments while attempting to correct records. (See pp. 7-10.) Most of the adjustments were not supported. One adjustment for \$68.8 million was to force agreement between the fund control accounts and subsidiary accounts. Despite knowledge of these adjustments and of the serious problems prevalent in the Center's financial system, the Center's comptroller certified that the accounts were correct on October 21, 1978. (See app. II.)

Defense Logistics Agency officials were also aware of the situation at the Center and of some of the actions taken in attempting to correct the Center's records. However, on October 30, 1978, the Agency's Deputy Comptroller certified the Center's accounts as correct without qualification. (See app. III.)

The Agency's certified report was forwarded to Defense, where it was consolidated with certified reports from other Defense agencies. The consolidated report was then certified on November 2, 1978, by the Defense Director of Budget and Finance, Washington Headquarters Service, and forwarded to the Defense comptroller. (See app. IV.) The Defense comptroller signed a cover letter forwarding the certified report to the Treasury.

Fiscal 1979 certification

During fiscal 1979, the Center made financial adjustments of \$263.1 million in an attempt to correct its records. (See pp. 10-15.) Again, most of the adjustments were not adequately supported. The Center's comptroller certified the fiscal 1979

accounts as correct on October 22, 1979, even though he knew of the adjustments and of the Center's continuing problems. (See app. V.)

The Defense Logistics Agency Deputy Comptroller also certified the fiscal 1979 accounts on October 30, 1979. (See app. VI.) Again, the Agency was aware of the situation at the Center.

As mentioned on page 14, the Center's comptroller attempted to qualify the 1979 certification with two disclosure statements in a November 21, 1979, memorandum to the Agency comptroller. (See app. VIII.) An Agency official told us that the memorandum was received too late for inclusion in the Agency or Defense certifications. The official also stated that the Agency's comptroller knew about the memorandum and its contents. On November 2, 1979, Defense again certified a consolidated report as discussed above, and forwarded the certified report to the Treasury. (See app. VII.)

The Department of Defense disagreed with our contention that the fiscal 1979 account balances certified had not been validated. Defense stated that when the Center asserted in the certification that "all known transactions creating valid obligations reported are correct, it is a true statement based upon accurate financial reports." The certified account balances were based on a series of statistical samples of unliquidated obligation balances over 120 days old.

While we believe the use of statistical sampling techniques to validate account balances is normally a proper approach, in this case the samples were not valid and could not be used as a basis to properly present the status of the account balances. The samples were not valid because, in most cases, the records to be sampled were inadequate or missing.

For example, of 6,146 unliquidated obligation balances sampled, adequate documentation could be found for only 1,650 balances, or 27 percent. Of the 1,650 balances, only 4 were found to be valid. The Center then decided to eliminate all of the balances. Despite the lack of adequate documentation of 4,496 balances, or 73 percent, the Center projected the results of the sampled balances to the entire universe of 60,934 balances without further validation. As a result, the total value of the universe--about \$98.3 million--was eliminated from the Center's records. (See app. I.)

After considering Defense's comments, we decided that additional investigation should be made by Defense to determine whether the certifying officials had violated 18 U.S.C. 1018

by knowingly certifying account balances they knew to be false. If any potential violations are found, Defense should inform the Department of Justice.

PROCESSING OF FRAUDULENT CONTRACT PAYMENTS

The chaotic condition of its funds control system and records precluded the Center from systematically preventing or detecting the processing of fraudulent payments. Fraudulent payments of \$794,101 were processed by Defense Contract Administration Services in 1977 for two of the Center's contracts. The fraudulent payments were detected only because of a clerical error.

On one contract, valid payment for \$306,749 was made by the New York Defense Contract Administration Services on August 26, 1977. Subsequently, fraudulent invoices were sent to the Philadelphia Defense Contract Administration Services. In making payment on the fraudulent invoices, the Services clerk erred and sent the check for \$306,749 to the legitimate vendor. In September 1977, the vendors contacted the Center to inquire why a duplicate check for \$306,749 was received for previously paid goods. Research by the Center and by the Services disclosed that a copy of an altered contract had been sent to the Services' Philadelphia office. The contract, valued at \$575,928, had been altered to direct payment of vendor invoices to an invalid address, and to change the payment office from New York to Philadelphia.

It was also discovered that fraudulently prepared vendor billing invoices were sent to the Philadelphia office supporting the duplicate check sent to the vendor. Fraudulent invoices were also submitted supporting a second check for \$29,981 that had been prepared but not yet mailed, and a third payment of \$231,998 for which a check had not yet been prepared.

In accordance with existing contract payment procedures, both checks would have been addressed to the invalid mailing address included on the altered copy of the contract except for a clerical oversight. The checks were addressed to the vendor's valid mailing address only because of the clerical error.

Further investigation also disclosed that a duplicate contract payment of \$225,373 was sent to another vendor under a contract valued at \$601,741. As in the first case, a copy of the contract was altered and sent to the Philadelphia office although Atlanta was the valid payment office. Fraudulent vendor billing invoices supported the amount of the

check. Again, the check was sent to the vendor's valid mailing address because of a clerical error. It was subsequently discovered that a copy of another contract with the same vendor valued at \$131,752 had been similarly altered, but no fraudulently prepared invoices were submitted.

In commenting on this point, the Department of Defense agreed with the facts we have presented. The Department does not agree, however, that the system would have prevented fraud if it had been working properly.

The Center has now implemented improvements to preclude the type of fraud discussed above. With the improvements, such fraud should be caught before any checks are issued, because the validity of addressees will be determined.

We have been requested by Agency officials not to reveal any details on the new procedures, but we believe that if they had been implemented prior to the attempted fraud, they probably would have prevented issuance of the checks.

CHAPTER 3

CAUSES OF INEFFECTIVE

FINANCIAL MANAGEMENT

The Center lost control of its funds because its accounting systems were not effective. The Center's two major commodities are managed under local systems that lack adequate controls and have not been submitted for approval by the Comptroller General as required by law. Contributing to the Center's funds control problems was the failure of the Defense Logistics Agency to implement its standard automated materiel management system for the two commodities. The standard system's financial subsystem has been approved by the Comptroller General. Task groups are in the process of converting the local systems to the standard system. Implementation of the standard system will not in itself correct the Center's funds control problems, however, unless inaccurate data is eliminated from the records and operational deficiencies, such as the following, are corrected.

- Required reviews and reconciliations to validate unliquidated obligations were not made.
- Many rejected financial transactions were not corrected promptly.
- Center personnel were not adequately trained.
- Files which documented financial transactions were missing or contained incomplete data.
- Written procedures and instructions for operating the Center's financial management system either did not exist or were outdated.
- Required reconciliations of the undistributed disbursements control accounts were not made.

Although the Center has initiated a financial management improvement program, it was based on fragmented attempts to identify and resolve problems. Our review shows that problems continue to exist. We believe that an overall plan is needed which uses the project management approach to ensure that all of the Center's funds control problems are quickly and effectively resolved.

FINANCIAL MANAGEMENT RESPONSIBILITIES
OF FEDERAL AGENCIES

The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66, 66a) places responsibility for establishing and maintaining adequate systems of accounting and internal control upon the head of each executive agency. The system must conform to the accounting principles, standards, and related requirements prescribed by the Comptroller General of the United States in accordance with that law and as set forth in the Policy and Procedures Manual for Guidance of Federal Agencies.

Effective accounting is an important part of any organization's internal management control system. Accounting records and reports must provide reliable financial information for use as a tool by management in carrying out its duties and responsibilities effectively, efficiently, and economically.

• Because effective accounting contributes significantly toward internal control objectives, an agency's accounting systems should be designed to consider a number of internal control requirements. These requirements include devising systems that will (1) comply with legal and other requirements, (2) properly account for all financial transactions, and (3) promptly provide accurate and reliable financial data to management. Effective control also requires continuing internal review to evaluate performance as it relates to efficiency, effectiveness, economy, and propriety.

The Defense Logistics Agency prescribes the financial management systems to be used by each of its supply centers to account for stock funds and to report the results of fund operations. Financial accountability for stock fund transactions, however, is the responsibility of each center.

STANDARD MANAGEMENT SYSTEM NOT IMPLEMENTED

Failure of the Defense Logistics Agency to fully implement its standard automated materiel management system at the Center contributed to the Center's funds control problems. The Center manages (1) clothing and textile and (2) subsistence items, its two major commodities, under locally designed systems that lack adequate controls and have not been submitted to the Comptroller General for approval, as required. The financial subsystem of the Defense Logistics Agency's standard system has been approved by the Comptroller General. Task groups are converting the local systems to the standard system. The implementation of the standard system will not

in itself correct the Center's problems, however, unless inaccurate financial data is eliminated from its records and operational problems are corrected.

In its January 1979 report, the Defense Audit Service stated that adequate internal and management controls over the processing of obligations and expenditure data were lacking at the Center. The task group established by the Center's comptroller to review the validity of recorded unliquidated obligations also found inadequate controls over the processing of obligations and expenditure transactions, which allowed many invalid amounts of unliquidated obligations to be recorded.

During the 1960s the Defense Logistics Agency developed a standard automated materiel management system for use by its supply centers. The standard management system was initially implemented in 1969 at one supply center, and in 1973 at all other supply centers except the Defense Fuel Supply Center and the Defense Personnel Support Center. The financial subsystem of the standard system was approved by the Comptroller General in 1973.

The standard system was scheduled for implementation at the Defense Personnel Support Center beginning in 1974 and was, in fact, implemented for medical items in October 1974. It has not yet been implemented for clothing and textile and subsistence items although about 87 percent of the total stock funds allotted to the Center were for these two commodities. The Center's two major commodities are still managed under local systems that have not been approved by the Comptroller General.

Implementation of the standard system for clothing and textile items was initially scheduled for April 1975, was rescheduled several times, and is currently scheduled for October 1980. The initial scheduled implementation date for subsistence items was September 1978 and it was rescheduled for 1982. A Defense Logistics Agency official told us that these delays occurred because Center personnel believed that the subsistence and clothing and textile commodities were so unique they should be excluded from the system. It was eventually decided, however, that the system could be modified to include the two commodities. Task groups are converting the two local systems to the standard management system.

UNLIQUIDATED OBLIGATIONS NOT VALIDATED

The Center did not perform required reviews and reconciliations to validate the amount of recorded unliquidated obligations since at least 1975. Without such reviews and

reconciliation there is no valid basis for determining whether recorded unliquidated obligation balances are accurate and can be certified. If reviews and reconciliations had been effectively performed and utilized, the Center's funds control problems would have surfaced much earlier.

A Defense Logistics Agency regulation requires that, as a minimum, unliquidated obligations be reviewed quarterly to determine whether they are valid and supported by documentary evidence. The review is to be performed by selecting an appropriate sample of unliquidated obligations on the basis of age and other criteria. The number of records to be reviewed is a management decision based on the results experienced in prior reviews. In most instances, however, all obligations over 360 days should be reviewed, and obligations that are 120 days old or less need not be reviewed. The review process should also validate that all obligations are being properly recorded.

The Defense Audit Service, in its January 1979 report, stated that reviews and reconciliations of unliquidated obligations had not been made since at least 1975. In response to these deficiencies, a task group established by the Center's comptroller began in July 1978 to review unliquidated obligation balances recorded in subsidiary records. The task group initiated actions to eliminate several hundred million dollars of recorded unliquidated obligations. However, the task group did not validate the remaining balances recorded and certified at the end of fiscal 1978 and 1979.

A permanent unit was established at the Center in March 1979 to perform continuing reviews and reconciliations of unliquidated obligations. Personnel assigned to the unit functioned as part of the task group until September 1979. If the permanent unit performs effective reviews and reconciliations, the results should be used as a basis for determining the validity of recorded balances, and whether unliquidated obligation balances can be certified as accurate.

The Department of Defense stated in an enclosure to its August 27, 1980, letter that the Center's problem was a consequence of inadequate staffing and inadequate system design. These inadequacies prevented effective review and correction of unliquidated obligation records. Initially, staffing in the problem areas was increased to help eliminate the problem. While clearing up the backlog in the area, Center personnel identified other system or procedural improvements which should reduce staffing needs while retaining effectiveness and increasing the speed and accuracy of the recordkeeping process. Some of these system or procedural improvements are as follows:

- A Data Entry System was implemented to ensure greater control over input to the system and greater validity to unliquidated obligation records.
- Two uncoordinated filing systems of disbursements were consolidated, making it easier to retrieve records of the Center's payments.
- A new system of labeling enabled identification and correction of computer systems deficiencies.
- The reconciliation of undistributed disbursements has been accelerated to allow earlier communication to management of the adequacy of reported expenditures.

MANY REJECTED TRANSACTIONS
NOT CORRECTED PROMPTLY

The Center's funds control system contained data that was neither current nor complete because many financial transactions that were rejected after being entered into the system were not corrected promptly. At the end of September 1979, there were 19,072 rejected and uncorrected transactions. Almost half of these transactions were generated prior to September. The amounts entered into the system for the uncorrected transactions totaled over \$1.5 billion (although, in some instances, there were gross errors in the entered amounts).

Financial transactions entered into the funds control system are checked for completeness and accuracy by automated validation tests. Transactions that fail the tests are rejected, and daily listings of the rejections are provided to appropriate personnel for research, correction, and resubmission.

To improve its financial operations, the Center established a target of 15 workdays to process obligation and expenditure transactions. Of the 19,072 rejected transactions that were uncorrected at the end of September 1979, 16,110 were for clothing and textile and subsistence items. The following table shows the age, by weeks, of the uncorrected transactions for the two commodities.

	<u>Age of transactions by weeks</u>					<u>Total</u>
	<u>2 or less</u>	<u>3-4</u>	<u>5-8</u>	<u>9-12</u>	<u>Over 12</u>	
Number	7,033	2,046	4,061	1,564	1,406	16,110
Percent of total	43.7	12.7	25.2	9.7	8.7	100.0

As shown in the table on page 24, nearly half of the transactions were uncorrected after 15 workdays. Significant delays in correcting transactions adversely affected the attainment of the management improvement goal.

In discussing this point, the Department of Defense indicated that the rejected transaction information was available only because a violation control system had been implemented in fiscal 1979. We recognize the system as a vast improvement; however, its effectiveness will be minimal until the rejected transactions are being promptly corrected.

PERSONNEL INADEQUATELY TRAINED

The lack of adequately trained personnel to manage and operate the funds control system was one of the causes of the Center's problems. In August 1978, the Center's commander issued a memorandum on the activity's accounting systems and funds control problems. Included was a statement that very few of the Center's professional accountants had more than minimal academic training in the accounting and financial management disciplines. It was also stated that the number of professional accountants with special training or practical experience with computer programming and applications was exceedingly low, and that there was no formalized training and development program for the accounting discipline.

A task group was established at the Center in June 1979 to investigate and resolve problems related to funds control. In its November 1979 report, the task group stated that Center personnel do not understand the funds control system, and therefore do not know how to process transactions.

The Department of Defense commented that the Office of Personnel Management had analyzed training needs in the Comptroller's office and concluded that they could identify no specific training requirements for the Center's accountants.

ADEQUATE DOCUMENTATION NOT AVAILABLE

Both the Defense Audit Service and Center personnel found that files which should support financial transactions were often missing or contained incomplete documentation. The General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies states that financial transactions shall be adequately supported in agency files with pertinent documents.

The Defense Audit Service in its January 1979 report stated that it had difficulty in reconciling amounts of recorded unliquidated obligations with supporting accounting records. One problem was that documentation files were incomplete or missing. The Comptroller's task group reviewing unliquidated obligations also encountered widespread problems in obtaining supporting documentation. We encountered similar problems during our review of unliquidated obligations recorded as of September 30, 1979. It is difficult to validate unliquidated obligations unless adequate documentation is available at the activity that is responsible for funds control.

WRITTEN OPERATING PROCEDURES
AND INSTRUCTIONS OUTDATED
OR NONEXISTENT

Written procedures and instructions for operating many segments of the Center's funds control systems were outdated or did not exist. The lack of adequate written guidance creates uncertainty as to the proper methods to be used by personnel in processing and accounting for financial transactions. Uncertainty leads to inaccurate or incomplete accounting system data.

Our Policy and Procedures Manual for Guidance of Federal Agencies states that each accounting system should be documented in an organized manual of instructions. The manual should describe the system in detail, display the forms used, state the procedural steps, and illustrate the reports issued. The sections of the manual should be developed in such a manner that the instructions are adequate for day-to-day use by accounting and other personnel, and should prescribe procedures for the recording of financial transactions.

The Defense Audit Service, in its January 1979 report, stated that written procedures did not exist or were outdated in many areas involving processing of obligations and expenditures. A task group established at the Center to help resolve funds control problems also stated, in its November 1979 report, that written funds control procedures and instructions were either outdated or did not exist. The Center has initiated a project to update its manual of policies and procedures for all comptroller activities. The project is scheduled for completion in May 1980.

In commenting on this issue, the Department of Defense stated that to enable accurate determination of future unliquidated obligation balances, written procedures have been published as Comptroller Office Staff memoranda over the last 18 months.

UNDISTRIBUTED DISBURSEMENTS FUND
CONTROL ACCOUNTS NOT RECONCILED

Until April 1979, the Center did not attempt to reconcile the balances recorded in its undistributed disbursements accounts with supporting records, although a monthly reconciliation is required by both Department of Defense and Defense Logistics Agency regulations. The Center's reconciliation of balances recorded at the end of March 1979, for each of its three commodities, disclosed that a large portion of the account balances could not be reconciled with supporting records.

An undistributed disbursement is a payment made which has not yet been recorded as an expenditure in stock fund accounting records. Department of Defense and Defense Logistics Agency regulations require monthly reconciliations of account balances to identify and control differences between disbursements made and reported by disbursing officers, and the cash transactions recorded in stock fund accounting records. The Center did not perform such reconciliations until April 1979. The initial reconciliations disclosed that a large portion of the account balances could not be reconciled with supporting records and so were classified as unidentified disbursements.

The following table compares the total account balances for all three commodities at the end of March and August 1979, and the portion that comprises unidentified disbursements.

<u>Month</u>	<u>Total account balances</u>	<u>Unidentified disbursements</u>
	-----	-----
	(millions)	
March 1979	\$156.5	\$69.0
August 1979	188.7	24.8

As the chart shows, the situation improved considerably by the end of August, but there were still significant balances of unidentified disbursements.

OVERALL PLAN FOR CORRECTING
FUNDS CONTROL PROBLEMS NEEDED

The Defense Personnel Support Center has no overall plan to guide and measure progress in identification and correction of its funds control problems. We are concerned that, unless the Center has such a plan, its attempts at correction will be fragmented and ineffective, and will not result in prompt identification and correction of all problems.

The Center did not have a financial management improvement program before fiscal 1979. Such a program was initiated in fiscal 1979, but it was developed without a comprehensive analysis of all aspects of the Center's funds control procedures and practices. The results of our review show that problems continue to exist even though the Center attempted to correct them.

The Defense Audit Service and two Center task groups reviewed aspects of the Center's funds control system and identified problems. However, none of the review groups made indepth evaluations of all aspects of the Center's funds control procedures and practices because of the extensive problems and time and staffing constraints. The Center's financial management improvement program is directed primarily toward correction of problems identified during these reviews.

The Center's approach to its problems consists of fragmented attempts at identification and correction. It makes no intensive effort to systematically identify all causes for problems or to develop and implement effective and timely corrective actions.

We therefore believe that a project management approach is needed to correct the Center's funds control problems. Under this approach an overall plan would be established to guide and measure progress in resolving problems. Such a plan would

- define the basic problems;
- instigate the development of management processes to identify the causes of problems and determine resources needed to implement the processes;
- design specific actions to eliminate causes of problems, establish milestones for implementing the actions, and monitor progress; and
- devise criteria to measure the effectiveness of problem-solving actions.

We believe the project management approach would lead to timely and effective resolution of the Center's funds control problems.

The Director of the Defense Logistics Agency has already established such a team and it has begun work at the Center. The team includes accounting, contracting, and supply personnel and its task is to develop an overall plan for resolving the Center's financial management problems. The Department of Defense stated that Defense will monitor progress of the team until corrective actions are completed.

CHAPTER 4

CONCLUSIONS, RECOMMENDATIONS, AND

AGENCY COMMENTS

CONCLUSIONS

The Defense Personnel Support Center's funds control system had a complete breakdown. Large erroneous balances of unliquidated obligations were recorded, and the Center could neither systematically prevent nor detect erroneous or fraudulent payments. The Center and the Defense Logistics Agency were aware that serious problems existed for several years but the problems were not given high priority attention until recently.

Although several hundred million dollars of adjustments were made in an attempt to correct older records, all inaccurate records were not corrected, and newly created records will continue to be inaccurate unless all the Center's problems are identified and corrected. In addition, if invalid data is transferred to the standard automated materiel management system, the implementation of the system will not have the desired effect of improving the Center's financial operations.

Certifying officials at the Defense Logistics Agency and at the Center knew of the problems in the Center's financial system and the actions taken to arrive at account balances for certification. Since the officials were aware of the lack of supporting documentation for the certifications, a determination should be made by Defense as to whether the certifications were made when known to be false, within the terms of 18 U.S.C. 1018.

The Center has attempted to identify and correct some of its problems, but the results of our review show that problems still exist. A comprehensive financial management plan is needed to ensure that all of the Center's funds control problems are corrected.

RECOMMENDATIONS

We recommend that the Secretary of Defense investigate the fiscal 1978 and 1979 certificates submitted by the Center and the Defense Logistics Agency to determine if they were made when known to be false--which would be in violation of 18 U.S.C. 1018. If a violation has occurred, the Justice Department should be informed.

We also recommend that the Secretary of Defense have the Director, Defense Logistics Agency

- establish a project team to develop an overall plan for resolving the Defense Personnel Support Center's funds control problems;
- closely monitor and submit progress reports on the full implementation of the Defense Logistics Agency's standard automated materiel management system at the Defense Personnel Support Center to ensure that the milestone dates for the various conversion phases are met;
- ensure that the Defense Personnel Support Center strengthens its reconciliation and validation procedures, improves its practices for correcting rejected financial transactions, provides adequate training to its personnel, improves its recordkeeping, and prepares written procedures and instructions for operating its funds control system;
- ensure that the Defense Personnel Support Center's financial control account balances are reconciled with supporting records, and that amounts recorded in supporting records are validated before the financial data is incorporated into the standard automated materiel management system; and
- ensure that the Defense Personnel Support Center's future reports of financial condition are qualified as necessary.

Furthermore, because of the seriousness of the Defense Personnel Support Center's problems, we recommend that, before the fiscal 1982 appropriations hearings, the Secretary of Defense provide an overall plan to the Chairmen of the House and Senate Committees on Appropriations defining the Center's funds control problems and their causes, specifying corrective actions and milestones for implementing the actions, and specifying the criteria to measure the effectiveness of actions taken.

AGENCY COMMENTS

In an August 27, 1980, letter (see app. IX), Defense concurred with all of our recommendations and has already established a project team to develop an overall plan for resolving the Center's financial management problems.

Defense acknowledges that, although there have been serious problems at the Center for several years, the situation is not yet corrected. Defense agrees that the Center's system lacks adequate financial controls, has too many errors, and is not supported fully by documentation.

Other comments made by Defense pertaining to the accuracy of balances certified, whether 18 U.S.C. 1018 may have been violated, and improvements to the system are discussed throughout the report.

CHAPTER 5

SCOPE OF REVIEW

The objectives of our review were to:

- (1) Determine whether the accounting systems provide maximum assurance that appropriations are not overobligated and/or overexpended.
- (2) Identify potential serious weaknesses in the accounting systems which would have an impact on financial operations.
- (3) Determine the extent of actions taken by the Center to correct known deficiencies in the accounting system.

To attain these objectives our review involved:

- Assessing the accuracy and completeness of selected financial data included in the Center's annual certified statements of stock fund financial condition for fiscal 1977 through 1979.
- Analyzing compliance by the Center and the Defense Logistics Agency with laws and regulations requiring operation of effective accounting systems, and certification and full disclosure of financial information.
- Assessing the adequacy of the Center's procedures for reconciling financial account balances and validating recorded unliquidated obligations.
- Assessing the adequacy of the Center's procedures for correcting financial transaction violations.
- Analyzing support for selected adjustments made by the Center to financial records during fiscal 1978 and 1979.
- Analyzing the Center's efforts during fiscal 1978 and 1979 to correct amounts of unliquidated obligations recorded in financial control accounts and supporting subsidiary accounting records.
- Determining the validity of unliquidated obligations recorded in the Center's subsidiary accounting records as of September 30, 1979.
- Examining correspondence, memorandums, and reports prepared by the Center or the Defense logistics Agency concerning funds control problems.

- Discussing the Center's funds control problems with both Center and Defense Logistics Agency officials.
- Analyzing the efforts by both the Center and the Defense Logistics Agency to identify and correct funds control problems and their underlying causes.
- Obtaining information on the processing of fraudulent contract payments under the Center's contracts.

To the extent practicable, we used the work performed by the Defense Audit Service. Due to the extensive problems prevalent in the Center's financial management system and time and staffing constraints, we did not attempt to identify all the causes for the Center's funds control problems.

Our work was performed at the Defense Personnel Support Center, Philadelphia, Pa.; Defense Audit Service, Philadelphia Region, Philadelphia, Pa.; and Defense Logistics Agency headquarters, Alexandria, Va.

TECHNICAL ASPECTS OF OUR ESTIMATES
OF UNLIQUIDATED OBLIGATIONS
RECORDED IN SUBSIDIARY RECORDS

We obtained computer files of unliquidated obligations recorded in subsidiary accounting records as of September 30, 1979, for each of the three commodities managed by the Center. From these files, we identified for each commodity the total number and dollar value of those unliquidated obligation balances with a nonzero balance that were more than 120 days old. We selected sample sizes for each commodity based on the number of records which could be reviewed within a prescribed period of time. After computing a sampling interval for each commodity by dividing the total number of applicable records in the file by the size of the samples, we obtained a starting point for each sample from a random number table.

We reviewed sampled records to determine their accuracy and then used the results to estimate, for each commodity, (1) the total number of inaccurately recorded unliquidated obligation balances that were more than 120 days old and (2) the total recorded dollar value of unliquidated obligations that were inaccurate. All estimates were at the 90-percent level of statistical confidence.

We estimated the number of incorrectly recorded balances for each commodity by applying the frequency of errors disclosed by the review of sampled records to the total number of applicable records. We then estimated the portion of the total recorded dollar value of unliquidated obligations that

was incorrect for each commodity by computing the differences between (1) the correct value identified by the review of sampled records and (2) the total recorded value of all sampled records. The differences were then applied to the total value of all applicable records for each commodity.

FISCAL 1979 REVIEWS OF SUBSIDIARY

RECORDS IN WHICH ADEQUATE DOCUMENTATION COULD NOT BE LOCATED

TO VALIDATE MANY UNLIQUIDATED OBLIGATION BALANCES

Commodity and review number	Number of records		Number of records--results of review				Total net dollar value of balance eliminated
	Total	Selected for review	Inadequate documentation to determine validity	Valid balance	Invalid balance	Other	
<u>Clothing and textile</u>							
79-1	1,486	50	7	4	39	-	\$ 58,267
79-2	381	54	10	-	38	6	15,612,434
79-3	201	201	133	-	68	-	4,866,824
<u>Subsistence</u>							
79-1	13,708	2,901	2,400	-	501	-	24,859,999
79-2	23,427	1,058	197	-	861	-	12,741,427
79-4	129	129	91	-	38	-	3,414,736
79-5 (note a)	2,764	30	21	-	9	-	5,495,993
	5,500	1,350	1,350	-	-	-	5,213,993
<u>Medical</u>							
79-2 (note b)	124	124	102	-	-	22	131,700
79-3	10,519	195	162	-	33	-	4,699,023
79-4	2,695	54	23	-	31	-	21,239,866
Totals (records)	<u>60,934</u>	<u>6,146</u>	<u>4,496</u>	<u>4</u>	<u>1,618</u>	<u>28</u>	
Subtotal (adjustments)							<u>98,334,262</u>
<u>Subsistence</u>							
79-3	9,434	-	unknown (note c) -	-	963	-	<u>52,565,288</u>
Total (adjustments)							<u>\$150,899,550</u>

a/Four subreviews made but only two identified problems with inadequate documentation.

b/Two subreviews made but only one identified problems with inadequate documentation.

c/Unidentified number.

APPENDIX I

APPENDIX I



DEFENSE LOGISTICS AGENCY
HEADQUARTERS, DEFENSE PERSONNEL SUPPORT CENTER
2800 SOUTH 20TH STREET
PHILADELPHIA, PENNSYLVANIA 19101

OCT 21 1978

REPLY
REFER TO DPSC-ZACC (GAGLIANO/mo/2753)

SUBJECT: 30 September 1978 Defense Stock Fund Statement of
Financial Condition Statement 1, DLA Form 75 -
Clothing & Textiles

TO: Director
Defense Logistics Agency
Attn: DLA-CFS

Subject document, in triplicate, forwarded in accordance with
paragraph 70603, DLAM 7000.1.

CERTIFICATION

"I heraby certify that the amounts shown in this report are
correct. All known transactions meeting the criteria of 31
U.S.C. 200 (A) have been obligated and are so reported."

OCT 21 1978

Date

FOR THE COMMANDER:

Encl

Nelson Levin
NELSON LEVIN
Comptroller

Nelson Levin
NELSON LEVIN
Comptroller

- C o p y -

30 OCT 1978

DLA-CFS (Mr. Foust/46224)

SUBJECT: FY 1978 Year-End Certification, Defense Stock Fund, 97X4961

TO: Director
Washington, Headquarters Service
ATTN: Chief, Finance and Accounts Branch
Washington, D.C. 20301

1. The attached report on Budget Execution, RCS-DD-COMP(M)1125 (DD Form 1176), is submitted in accordance with ASD(C) memorandum, subject: Accuracy and Timeliness of Accounting and Budget Data, dated 8 August 1977, and with DoD 7220.9H.

2. I hereby certify that the amounts shown on the enclosed report are correct. All known transactions meeting the criteria of 31 U.S.C. 200(a) have been obligated and are so reported.

FOR THE DIRECTOR:

Signed W. E. KENEALY
CAPT, SC, USN
Deputy Comptroller

Encl

MFR: This report is supported by individually certified reports from each allotted fiscal station.

Mr. Foust/pb/46224/30OCT78
Mrs. Wilson/LTC Resa
Mr. Bordley

- Copy -

AGENCY **MINNEAPOLIS**
30 September 1978

**STATEMENT OF UNEXPENDED BALANCES OF APPROPRIATIONS AND FUNDS (TREASURY)
 REQUEST FOR TRANSFERS AND RESTORATIONS (31 U.S.C. 704)
 AND
 ANALYSIS OF APPROPRIATION AND FUND BALANCES (ADMINISTRATIVE AGENCIES)**

1/10/1 1 5006
 175 (FORM 1968) (REV. 11-15-77)
 OFFICE OF MANAGEMENT AND BUDGETING
 DEPARTMENT OF COMMERCE
 1400 M STREET, N.W.
 WASHINGTON, D.C. 20503

DEPARTMENTAL BALANCE				FUNDS AND APPROPRIATIONS (31 U.S.C. 704)			TOTAL APPROPRIATION				STATUS OF SERVICES		
FUND	PROGRAM	SUBPROGRAM	ITEM	Unexpended Balance	Obligated Balance Transferred to "B" Accounts	Unobligated Balance Available for Services (A)	Unexpended Balance	Other Anticipations	BY OBJECT		Unobligated Balance and Other Available for Obligation	Unobligated Balance Available for Obligation	
									Personal Services and Benefits	Other			
				(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	(in \$ mil. 000)	
97			4961	539,204,243.23			539,204,243.23		462,361,123.45	473,535,100.12	2,255,826,134.36	458,532,607.00	
37			4961	239,250,076.59				239,250,076.59					
				778,462,319.82			539,204,243.23	239,250,076.59	462,361,123.45	473,535,100.12	2,255,826,134.36	458,532,607.00	
57			4767	55,467,525.61			55,467,525.61		23,196,740.76	15,686,927.00	7,929,477.76	87,251,260.75	
				833,929,845.43			594,671,768.84	239,250,076.59	485,557,864.21	489,222,027.12	2,263,755,612.12	519,783,867.75	
												27,170,456.06	
												27,170,456.06	

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NOTE: THIS ORIGINAL FORM AND ONE COPY MUST BE RETURNED. DO NOT RETYPE OR CHANGE ANY BALANCES.

DIRECT QUESTIONS TO: (202) 566-5834.

Russell Newman, Chief, Departmental Accounting Section. 694-4730 2 NOV 1978

PREPARER (TYPE OR PRINT) PHONE DATE

Carl W. Fisher, Director of Budget and Finance, WHS 2 NOV 1978

CERTIFYING OFFICER (TYPE OR PRINT) DATE

I HEREBY CERTIFY THAT THE AMOUNTS SHOWN IN THIS REPORT ARE CORRECT. ALL KNOWN TRANSACTIONS MEETING THE CRITERIA OF 31 U.S.C. 200(A) HAVE BEEN OBLIGATED AND ARE SO REPORTED.

Signed
 Signature

APPENDIX IV

APPENDIX IV



DEFENSE LOGISTICS AGENCY
HEADQUARTERS DEFENSE PERSONNEL SUPPORT CENTER
2800 SOUTH 20TH STREET
PHILADELPHIA, PENNSYLVANIA 19101

TO: DPSC-ZRCC (MURPHY/db/2753)

SUBJECT: 30 September 1979 Defense Stock Fund Statement of
Financial Condition Statement 1, DLA Form 75 -
Clothing & Textile

TO: Director
Defense Logistics Agency
ATTN: DLA-CFS

Subject document, in triplicate, forwarded in accordance with
paragraph 70603, DLAM 7000.1.

CERTIFICATION

"I hereby certify that the amounts shown in this report are correct.
All known transactions meeting the criteria of 31 U.S.C. 200(a) have been
obligated and are so reported."

10/22/79
Date

FRANK L. COCCIA
Comptroller

FOR THE COMMANDER:

FRANK L. COCCIA
Comptroller

Encl

- C o p y -

30 OCT 1979

DIA-CFG(CAO) (Mrs. Gilroy/274-7183/shs)

SUBJECT: FY 1979 Year-End Certification

TO: Director, Washington Headquarters Service
ATTN: Chief, Finance and Accounts Branch
Washington, D.C. 20301

1. The attached reports on Budget Execution, RCS DD-COMP(M)1125 (DD Form 1176), are submitted in accordance with Memorandum, ASD(C), subject: Accuracy and Timeliness of Accounting and Budget Data, dated 24 July 1979, and with DoD 7220.9H.
2. I hereby certify that the amounts shown on the enclosed reports are correct. All known transactions meeting the criteria of 31 U.S.C. 200(a) have been obligated and are so reported.

Operation and Maintenance, Defense Agencies

9790100.51
9780100.51
9770100.51
97M0100.51

Procurement, Defense Agencies

979/10300.51
978/00300.51
977/90300.51
976/80300.51
975/70300.51
97M0300.51

Research, Development, Test and Evaluation, Defense Agencies

979/00400.51
978/90400.51
977/80400.51
976/70400.51
97M0400.51

- C o p y -

30 OCT 1979

DLA-CFG(CAO)
SUBJECT: FY 1979 Year-End Certification

Military Construction, Defense Agencies

97/30500.51

Family Housing Management Account, Defense Agencies

979/30700.51
97X(07)0700.51

9790700(07).51
9780700(07).51
9770700(07).51
97M0700(07).51

Defense Production Guarantee

97X4080

Defense Industrial Fund

97X4962

Defense Audit Service

9790100.16
9780100.16

Defense Stock Fund

97X4961

FOR THE DIRECTOR:

Signed W. E. KENEALY
CAPT, SC, USN
Deputy Comptroller

2Encls

Mrs. Gilroy/47183/shs/30 Oct 79_____

See previous green for MFR & Coordination.

Mr. Coffee (signature)_____
Mr. Bordley_____

AGENCY D. F. N. E. AGEN 815
30 September 1979

YEAR-END CLOSING STATEMENT

IFB Form 2108 FORMER U.S. FORM 2108
 U.S. GOVERNMENT PRINTING OFFICE: 1978
 LEARNING UNIT OF THE SPECIAL EDUCATION SERVICE
 2000 2108 (REV. 10/78) (10/78) (10/78) (10/78)
 Changes on Left Side of Form are in Red Ink

UNAPPORTIONED BALANCE				TRANSFERS AND WITHDRAWALS (24 U.S.C. 204)			FUND RESOURCES				STATUS OF RESOURCES		
APPROPRIATION OR FUND SYMBOL				Portion Unexpended Balance (1) (2) (3)	Charged Balance Transferred to "B" Account (4)	Unexpended Balance Withdrawn (-) or Returned (+) (5)	Portion Unexpended Balance (6)	Other Authorizations (7) (8)	RECEIPTS		UNPAID OBLIGATIONS		Unexpended Balance Available for Obligation (13) (14) (15)
APP. NO.	FUND NO.	REVENUE	OBJ. NUMBER						Reimbursed From and Schools (9) (10) (11)	Unpaid Customer Orders (12) (13) (14)	Unpaid Orders and Comms (16) (17) (18)	Accounts Payable and Other Liabilities (19) (20) (21)	
97	X	4961		445,976,255.83			445,976,255.83		485,542,444.24	584,284,725.85	341,047,756.97	678,457,808.00	296,297,861.90
97	X	4961	961	1,321,642,341.75			1,321,642,341.75						1,321,642,341.75
				1,767,618,597.58			445,976,255.83	1,321,642,341.75	485,542,444.24	584,284,725.85	341,047,756.97	678,457,808.00	617,940,202.75
97	X	4962		79,468,816.61			79,468,816.61		17,145,480.87	17,252,488.09	8,039,575.15	74,062,861.86	31,764,348.56
				1,847,887,414.19			525,445,072.44	1,321,642,341.75	502,687,925.11	601,537,213.94	349,087,332.07	752,520,669.86	649,704,551.31

1/ Includes unearned revenues of 9,363,823.88

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NOTE: THIS ORIGINAL FORM AND ONE COPY MUST BE RETURNED. DO NOT RETYPE OR CHANGE ANY BALANCES.

DIRECT QUESTIONS TO: (202) 566-5834.

Russell Newman, Chief, Departmental Accounting Section 694-4730 2 NOV 1979

PREPARER (TYPE OR PRINT) PHONE DATE

Carl W. Fisher, Director of Budget and Finance, WHS 2 NOV 1979

CERTIFYING OFFICER (TYPE OR PRINT) DATE

I HEREBY CERTIFY THAT THE AMOUNTS SHOWN IN THIS REPORT ARE CORRECT. ALL KNOWN TRANSACTIONS MEETING THE CRITERIA OF 31 U.S.C. 200(A) HAVE BEEN OBLIGATED AND ARE SO REPORTED.

Signed
Signature

APPENDIX VII

APPENDIX VII

DPSC-Z

SUBJECT: FY 79 Stock Fund Statements

TO: Director
Defense Logistics Agency
ATTN: DLA-C

1. References:

- a. Financial Statements and Analysis for Defense Stock Fund Subsistence dated 30 September 1979. F-3
- b. Financial Statements and Analysis for Defense Stock Fund Clothing and Textiles dated 30 September 1979. F-1
- c. Financial Statements and Analysis for Defense Stock Fund Medical dated 30 September 1979. F-2
- d. Letter, DPSCZ, dated 20 October 1979, Subject: DPSC Financial Management Improvement Status Report. D-4z
- e. Title 2 of the General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies. D-45
- f. DLA-CFS staff assistance visit on 25 September 1979 which provided procedures to substantiate year-end accounts payable balances in the Financial Statements for the Subsistence Stock Fund. E-86

2. Reference 1d reported to your office the unliquidated obligation review procedures used to obtain the balance of unliquidated obligation amounts reported in references a, b, and c.

3. Reference 1e provides standards required in the preparation of financial reports in the Federal Government. One of these standards, fairness of presentation, requires full disclosure of the basis of reports or financial data if the source is other than the accounting system. The standard also requires disclosure if the financial data reported is derived from accounts that are not maintained in all material respects on a consistent basis from period to period.

4. Request you attach the enclosed disclosure note on unliquidated obligations to the year end Stock Fund statements referenced in 1a, b, and c. This note provides the same information on ULOs that was already reported to you in reference 1d.

DPSC-2

SUBJECT: FY 77 Stock Fund Statements

5. Request you attach the enclosed disclosure note on accounts payable to the year end Subsistence Stock Fund Statements referenced in 1a. This note provides the procedure that was used to substantiate accounts payable in the year end Subsistence Stock Fund statements. This procedure is the same one provided by OLA-CFS in reference 1f.

FOR THE COMMANDER:

Encl

FRANK L. COCCIA
Comptroller


WATER

DISCLOSURE NOTE ON ULO

This note provides full disclosure of the treatment of unliquidated obligation records in the Defense Subsistence, Medical and Clothing and Textiles Stock Fund Financial Statements and analysis reports for the year ending 30 September 1979. This disclosure note complies with the reporting standard, Fairness of Presentation, required by Title 2 of the General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies. This same information was provided in CPSC-2 Letter, Subject: DPSC Financial Management Improvement Program Status Report, dated 29 October 1979.

1. As of 31 January 1979, there were 102,315 records of unliquidated stock fund obligations for which the obligation was created prior to 1 October 1978, distributed as follows:

<u>UNLIQUIDATED OBLIGATIONS - (OVER 120 DAYS OLD) ^{1/}</u>		
<u>31 JANUARY 1979</u>		
<u>CATEGORY</u>		<u>NR OF RECORDS</u>
Clothing & Textiles		5,483
Medical		28,081
Subsistence		
Mechanical		
Brand Name	12,448	
Chill & Freeze	10,219	
Fruits & Vegetables	36,570	
Other	<u>2,556</u>	
Total Mechanical	61,793	
Manual ^{2/}	<u>6,958</u>	
Total Subsistence		<u>68,751</u>
Total All Categories		102,315

^{1/} For Medical, the number of records are those for which the obligation date was over 120 days prior and the scheduled delivery date was past (SAMMS F-2-11). For all others the count is for records with obligation dates over 120 days old regardless of delivery date.

^{2/} "Manual" subsistence records are those for which DCASRs provided us with contract level records as of 30 September 1978, and were excluded from the mechanized system.

Most of these records were invalid. They did not represent actual unpaid obligations. As of 14 October 1979, (the last day for posting FY 1979 activity) the records had been reduced to 3,938, distributed as follows:

UNLIQUIDATED OBLIGATIONS (AWARD PRIOR TO 1 OCT 78)
14 OCTOBER 1979

<u>CATEGORY</u>		<u>NR OF RECORDS</u>
Clothing & Textiles		873
Medical		1,321
Subsistence		
Mechanical		
Brand Name	225	
Chill & Freeze	-0-	
Fruits & Vegetables	-0-	
Other	<u>943</u>	
Total Mechanical	1,168	
Manual	<u>576</u>	
Total Subsistence		<u>1,744</u>
Total All Categories		<u>3,938</u>

These 3,938 records represent a combination of valid unliquidated obligations, records which have been reviewed and for which we are awaiting follow-up information, and records which have been identified to be cleared but the final transactions have violated.

2. The reduction in the number of invalid unliquidated obligation records was accomplished by identifying areas or groups of transactions with common characteristics, sampling a portion, and bringing the unliquidated obligation dollar value to zero for the entire group by recording expenditures and/or adjusting obligations based on the results of the sample. These actions covered the following areas:

<u>PROJECT NR.</u>	<u>DESCRIPTION</u>	<u>NR OF RECORDS</u>
C&T-79-1	ULO balance \pm \$250	1,486 ✓
C&T-79-2	Obligation date prior to 30 June 1975	355 ~-
C&T-79-3	Service Orders prior to 1 October 1978	201 ✓
C&T-79-4	Awards made in FY 76 & 77 for which procurement files are retired.	250
MED-79-2	Inter-Government Procurements prior to 1 October 1978.	102
MED-79-3A	DVD procurements prior to 1 October 78, delivery scheduled prior to 31 Mar 79, and shipment data posted.	8,448 ~
MED-79-3B	DVD procurements prior to 1 October 1978, delivery scheduled prior to 31 March 79, no shipment data, value less than \$500.	1,639 ✓
MED-79-4	Stock Buys with Receipts posted prior to 15 May 1979.	2,042
SUB-79-1	CONUS FF&V procurements prior to 31 Dec 1978.	12,995
SUB-79-2	European FF&V procurements prior to 31 Dec 1978.	23,344
SUB-79-3	Chill and Freeze Procurements prior to 31 Dec 1978.	6,905
SUB-79-4	Service Orders awarded prior to 1 Oct 1978.	129

SUB-79-5

OCAS paid contracts:

a. Mechanical record duplicates of manual records	1,078
b. Manual records - No activity since 28 Feb 1978	3,120
c. Brand Name mechanical awarded prior to 1 Oct 1978	5,974
d. Mechanical record for which a constructive expenditure was recorded in FY 78 and a deobligation in FY 79.	669
TOTAL RECORDS	68,747

3. Had we not taken the actions to eliminate these records, they would have undoubtedly remained in our computer files with unliquidated values indefinitely. The findings in each of our reviews indicated that subsidiary records of unliquidated obligations did not accurately reflect true balances. It is not reasonable to expect that these records could have been corrected as a result of individual record by record unliquidated obligation reviews. In addition to the magnitude of the manpower resources required, the lack of adequate documentation and transaction history records would have made such an effort impossible.

DISCLOSURE NOTE ON ACCOUNTS PAYABLE

This note provides full disclosure of the procedure used to substantiate accounts payable balances in the Defense Subsistence Stock Fund Financial Statements and Analysis Reports for the year ending 30 September 1979. This disclosure note complies with the reporting standard, Fairness of Presentation, required by Title 2 of the General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies. This procedure was provided to DPSC-ZA during a DLA-CFS staff assistance visit on 26 September 1979.

Total Accounts Payable

DPSC subsistence accounting records do not show accounts payable accurately. Alternate procedures, which are not part of the accounting system were utilized to derive the total accounts payable balance. These procedures are summarized briefly below.

Accounts Payable Balance Per DPSC Records	\$2,503,720.55
Undistributed Disbursements (estimated) in excess of Accounts Payable Per DPSC Records	49,055,307.49
Unpaid Supplier Invoices - 30 Sep 1979	<u>44,990,569.46</u>
TOTAL	<u>\$96,549,597.50</u>



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D. C. 20301

AUG 27 1980

Mr. D. L. Scantlebury
Director, Division of Financial and
General Management Studies
U.S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Scantlebury:

This is in response to your letter, dated July 15, 1980, to the Secretary of Defense, in which you enclosed your GAO Draft Report, "Financial Mismanagement of Defense Personnel Support Center" (DPSC) (Code 901310).

We concur with your recommendations to establish a project team to develop a plan to resolve the DPSC's funds control problems. The Director, Defense Logistics Agency, has already established the team and it has proceeded to DPSC to begin work. We will monitor the progress of the team until corrective actions are completed. With regard to your recommendation that we provide an overall plan to the Chairmen of the House and Senate Committees on Appropriations to define the DPSC problems, specify corrective actions with milestones, and specify the criteria to measure the effectiveness of actions taken, we will be prepared to submit such a plan at the appropriate time.

We generally concur with your other findings and recommendations. However, we do not believe that your intention to refer the information on the matter of the Fiscal Year 1978 and 1979 certifications to the Department of Justice for investigation is justified. We believe that the enclosed response by the Director, Defense Logistics Agency, provides sufficient information and justification for you to modify your position.

I want to emphasize our resolve that the DPSC problems be corrected as soon as possible and our intent to work closely with the Defense Logistics Agency to this end.

Sincerely,

John R. Guetsch
Principal Deputy Assistant Secretary of Defense
(Comptroller)

Enclosure



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA VIRGINIA 22314

11 AUG 1980

MEMO
REF ID: DLA-CFF

MEMORANDUM FOR DEPUTY ASSISTANT SECRETARY OF DEFENSE (MANAGEMENT SYSTEMS)

SUBJECT: GAO Draft Report, Financial Mismanagement of Defense
Personnel Support Center (Code 901310)

The draft report states that the Defense Personnel Support Center (DPSC) lost control of hundreds of millions of dollars of stock funds and could not accurately determine the amounts paid and amounts of unliquidated obligations because its accounting systems were ineffective. The draft report states that DPSC had made adjustments of \$566.5 million during FYs 1978 and 1979 in an attempt to correct its financial records; however, the validity of these adjustments could not be determined because they were not adequately supported by documentation.

The draft report also concludes that the FY 1978 and 1979 accounts which were certified by DPSC and DLA officials as being correct may have violated 18 U.S.C. 1018 because the certifications were made despite knowledge of DPSC's financial problems.

Finally, the draft report concludes that the chaotic condition of DPSC's fund control system and records precluded the systematic prevention and detection of fraudulent contract payments and, in fact, fraudulent payments were processed.

There have been serious problems in the financial management operations at DPSC for several years. Both DPSC and this Headquarters have taken steps to improve the situation. Unfortunately, the situation is not yet completely corrected. This audit report's basic findings only reaffirm the findings of an earlier DAS audit that was performed at our request and our original review: the local systems lack adequate financial controls and audit trails; have too many errors; and are not supported fully by documentation. In addition, Standard Operating Procedures are incomplete and there has been inadequate training.

We agree with the specific recommendations to DoD. A project team headed by Brigadier General DeMoss has been established, and includes accounting, contracting, and supply personnel; it will begin on 11 August 1980 to develop an overall plan for resolving the DPSC financial management problems. While we believe that significant progress has been made at DPSC, we agree with GAO that much more remains to be done, and that it should be done expeditiously.

We have reviewed the draft report and our detailed comments are enclosed. A summary of those comments follows.

11 AUG 1980

DLA-CFF

SUBJECT: GAO Draft Report, Financial Mismanagement of Defense
Personnel Support Center (Code 901310)

Fiscal Year 1978. The draft report notes that DPSC statistically analyzed its recorded unliquidated obligations in subsidiary records as of July 31, 1978 and found significant errors. The draft report questions the validity of DPSC's certification of the unliquidated obligations balances at the end of the fiscal year given the knowledge obtained from the statistical sample. Furthermore the draft report states that the balances were not validated. The draft report points to adjustments of \$303.4 million which were made to subsidiary records (\$184.6 million) and control accounts (\$118.8 million), the majority of which the draft report believes were inadequately supported. We have reviewed the adjustments identified in the draft report and we believe that those adjustments were adequately supported.

Of the \$184.6 million of adjustments to subsidiary records, the draft report agrees that \$49.1 million were supported. The remaining adjustments (\$135.5 million) were made to subsidiary accounts of the subsistence commodity and were based on a comparison of DPSC's records with records from the Defense Contract Administration Services. The draft report concludes that these adjustments were improper. We disagree and our reasons are provided in Enclosure 1.

Adjustments to control accounts amounted to \$118.8 million and consisted of adjustments to the commodity unliquidated obligations control accounts (Clothing & Textiles, Subsistence, and Medical) amounting to \$68.8 million, and an adjustment to the undistributed disbursement control account for medical of \$50.0 million.

The adjustments to the commodity unliquidated obligation control accounts were made to bring them in line with the subsidiary records which had been reviewed by DPSC. GAO states the adjustment was improper because the subsidiary records were not validated. Details concerning the review of the subsidiary records are also in Enclosure 1.

The adjustment to the undistributed disbursement control account for medical items was made to bring that account in line with Treasury Department reports which is required by Office of Management and Budget Circular A-11, Preparation and Submission of Budget Estimates, sections 32.5 and 32.8 and Department of Defense regulations (DoD Accounting Guidance Handbook 7220.9-H, section 321-23, paragraphs 32108 C 46 and 47). Details concerning the adjustment are also in Enclosure 1.

In summary HQ DLA and DPSC were aware of the problems associated with DPSC's accounting systems. Many of these problems had been documented by a review of DPSC's accounting systems performed by the Defense Audit Service during the period October 1977 through June 1978. Based on this review, corrective

11 AUG 1980

DLA-CFF
SUBJECT: GAO Draft Report, Financial Mismanagement of Defense
Personnel Support Center (Code 901310)

actions were initiated at DPSC to improve financial control and substantial improvements had been made. Based on these corrective actions and the propriety of the adjustments made to subsidiary and control accounts, as detailed in the enclosure, we believe that the Fiscal Year balances as reported and certified by DPSC and DLA present, within acceptable limits, an accurate reflection of financial operations during the fiscal year. It should be noted that the draft report does not conclude that the FY 1978 balances as reported and certified were inaccurate. Rather, the draft report implies year end inaccuracies based on known inaccuracies as of July 31, 1978 coupled with questioned adjustments made between July and September 1978.

Fiscal Year 1979. For FY 1979 the GAO did analyze the balances which were reported and certified, and concluded that those balances were inaccurate, with the exception of the unliquidated obligations balance for the medical commodity. While this after-the-fact analysis may tend to show that there were errors in the balances reported and certified (our comments on the statistical analysis are enclosed) the analysis does not show in any way that errors were known at the time the balances were reported and certified.

The draft report notes that during FY 1979 DPSC made 12 reviews of unliquidated obligations balances recorded in subsidiary accounts which resulted in reductions to those balances of \$169.1 million. Further, the report notes that DPSC made year end adjustments to control accounts of \$94.0 million. The draft report states that these adjustments, which total \$263.1 million, were not adequately supported.

Of the \$169.1 million of adjustments to subsidiary records, the draft report specifically identifies only \$30.2 million of the adjustments, consisting of a \$25.0 million reduction in the subsidiary unliquidated obligations record balance for fresh fruits and vegetables (FF&V) and a \$5.2 million reduction in the subsidiary unliquidated obligations record balance for brand name subsistence. Details concerning these adjustments are enclosed. The draft report provides no details for the remaining \$138.9 million of adjustments to subsidiary records. The draft report merely states that many of these adjustments were not supported by adequate documentation and were made on the basis of assumptions. Details concerning the 12 reviews and the resulting adjustments are in Enclosure 2.

The \$94.0 million adjustment was made to the subsistence commodity's accounts payable control account. Details concerning this adjustment are also in Enclosure 2.

Based on the 12 reviews of unliquidated obligation balances and the reasonableness of adjustments to subsidiary and control accounts, we believe the fiscal year balances as reported and certified by DPSC and DLA present, within acceptable limits, an accurate reflection of financial operations during fiscal year 1979.

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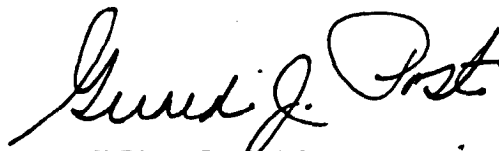
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The draft report states an opinion that the Fiscal Year 1979 certified statements should have disclosed these adjustments and that failure to disclose the adjustments necessarily results in a false certification. Details regarding disclosure are in Enclosure 3. The draft report's conclusion that the chaotic condition of DPSC's fund control system and records precluded the systematic prevention and detection of fraudulent payments is not supported by the example cited. The example relates to payments by the Defense Contract Administration Services Region in Philadelphia which were made during 1977. Conceptually, there is no way that even the GAO approved SAMMS system, had it been installed at DPSC, could have prevented these particular payments from occurring. The payment action would take place prior to any processing against DPSC's records. DPSC's funds control system could not be designed as a first line of defense against similar-type fraudulent payments. The statement in the draft report that DPSC personnel could not explain how the fraud occurred is misleading in that it implies that DPSC personnel should have been able to explain how the fraud occurred when, in fact, the details were deliberately and properly kept from them. Discussion of the specific example is in Enclosure 4 and explains why DPSC personnel had no reason to be aware of the circumstances surrounding the payment.

The draft report, in discussing the \$566.5 million of adjustments made to subsidiary records and control accounts during FY 1978 and 1979, states that an official of the Agency (DLA) told a GAO representative that the adjustments were not material in relation to total stock fund operations and did not warrant disclosure. The DLA official did make such a statement; however, the manner in which the statement appears in the draft report takes the statement totally out of context. A discussion of the circumstances surrounding the statement is in Enclosure 5.

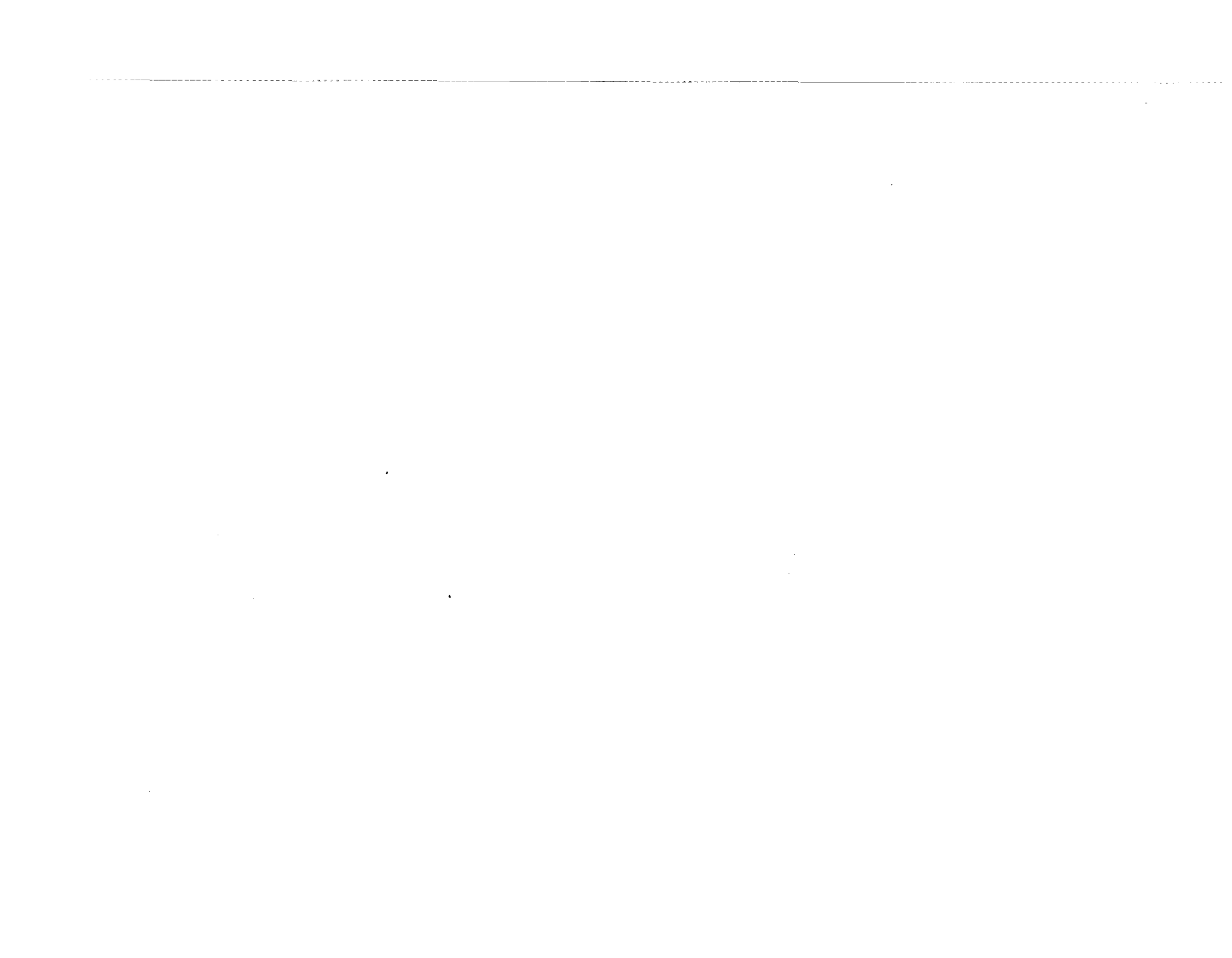
Finally, corrective actions which were initiated at DPSC to improve financial control were not addressed in the draft report. Details of these corrective actions are in Enclosure 6.

6 Enc1



GERALD J. POST
Lieutenant General, USAF
Director

GAO Note: Because of the length of the enclosures, they have not been included in the report. The Director of the Defense Logistics Agency's memorandum adequately summarizes the enclosures.



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