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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D C 20548

INTERNATIONAL DIVISION

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MAY 23 1972

Dear Mr. Donelan:

Over the past few years, we have examined into various aspects of centralized administrative services performed by the Department of State. An important part of our work, performed during the latter part of fiscal year 1971, consisted of a review of the accounting system in operation for the Department's Working Capital Fund. The Fund was established to develop an improved method of managing, financing and accounting for centralized administrative services.

We have noted that, although the Department initially intended in fiscal year 1965 to utilize the Fund for services benefiting activities funded from various appropriations, the Department has excluded from the Fund most of the multi-appropriation services. During fiscal year 1971, for example, the Department financed from its Salaries and Expenses appropriation, rather than the Fund, administrative expenses costing about \$21.5 million, which included about \$6.7 million applicable to other appropriations, while the billings for services financed by the Fund, about \$7.2 million, included only about \$1.5 million for the other appropriations. Except for this \$1.5 million, the services financed by the Fund were billed to the Department's Salaries and Expenses appropriation.

We see nothing improper in including in the Fund services that primarily benefit Departmental activities. Although the inclusion of such services results in few financing advantages, we believe that their inclusion does permit more accurate accounting for user costs, thereby providing a better basis for the promotion of cost-consciousness on the part of both the suppliers and the users of the services. The promotion of cost-consciousness was a major management benefit expected by the Department when the Fund was first established.

Similar opportunities for obtaining management improvements through the promotion of cost-consciousness have obviously been lost, however, in the case of services that have been excluded from the Fund. Our work has indicated that some of the exclusions have especially restricted the potential usefulness of the Fund.

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An example of multi-appropriation services excluded from the Fund is the Department's world-wide supply system. The supply system includes several overseas supply centers for the servicing of user organizations, but the Department has included in the Fund only the supply center at Washington, D.C. Each overseas supply center is operated as a separate entity--outside the Fund--without a unified set of management controls.

We believe that these exclusions have restricted the potential usefulness of the Fund not only because overseas supply services performed for user organizations have been excluded but also because much of the U.S. supply operation that has been included consists of services performed for the overseas supply centers. Thus, only part of the included supply services involves services performed for the ultimate supply users.

We have therefore concluded that the Fund has contributed little toward the development of an improved method of managing, financing and accounting for supply services performed by the Department. In our opinion, the Department can obtain significant benefits from the inclusion of supply activities in the Fund only if it includes the complete supply system.

Other examples of excluded multi-appropriation services are the services performed by the Regional Finance and Data Processing Center at Paris, France, and the data processing services performed at Washington, D.C. As we indicated in our letter dated March 22, 1971, the data processing services performed at these two locations are closely related and worthy of being considered jointly for management purposes. We believe that their inclusion in the Fund, in addition to promoting better management of data processing activities as a result of increased cost-consciousness, could provide a better basis for future management decisions on improving the activities requiring data processing services.

We want to emphasize that the exclusion of services from the Fund has significant effects on the usefulness of the Department's allotment accounting system in identifying operating costs. For some time now, the Department has relied primarily on its system of accounting for allotments to obtain data on operating costs, and we agree that useful operating costs should be so identified in the case of services included in the Fund. In the case of services excluded from the Fund, however, the Department's allotment accounting identifies costs as they are initially incurred by the organizations providing the services, rather than as they are actually incurred by the organizations using the services. The allotment accounts for the excluded services, therefore, do not identify operating costs incurred by the Department's program managers.

We recognize that a working capital fund is not a prerequisite to the identification of operating costs and the promotion of cost-consciousness. We believe, however, that if the Department wishes

to use this method with respect to centralized administrative services, it should include all appropriate services in the Fund. We believe further that the Department continues to have a need for some form of cost accounting.

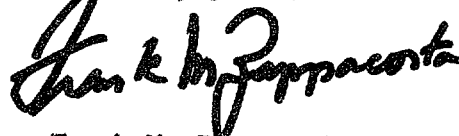
Accordingly, we recommend that the Department either expand the Fund to permit the intended development of an improved method of managing, financing, and accounting for centralized administrative services or replace the Fund with appropriate accounting for accumulating costs and distributing them to the various operating entities.

The attachment to this letter, entitled Accounting System Weaknesses, Working Capital Fund, Department of State, contains a number of additional items that we noted during our review of the Fund's accounting system in operation. The identified weaknesses pertain to the Fund as it is now being operated, and consequently are relatively minor compared with the over-riding question of usefulness discussed above. We nevertheless believe that they deserve attention, and we recommend that they be corrected if the Department determines that the Fund should be retained.

We will appreciate receiving your views on the matters referred to above, including advice of all actions taken or contemplated as a result of this report.

We are sending copies of this report to the Subcommittee on Foreign Operations and Government Information, House Committee on Government Operations, and to the Office of Management and Budget.

Sincerely yours,



Frank M. Zappacosta  
Assistant Director

The Honorable Joseph F. Donelan, Jr.  
Assistant Secretary, Bureau of Administration  
Department of State

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Attachment

ACCOUNTING SYSTEM WEAKNESSES

WORKING CAPITAL FUND

DEPARTMENT OF STATE

May 23, 1972

U.S. GENERAL ACCOUNTING OFFICE

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ACCOUNTING SYSTEM WEAKNESSES  
WORKING CAPITAL FUND  
DEPARTMENT OF STATE  
May 23, 1972

GENERAL COMMENTS

We identified the accounting system weaknesses described in this document by reviewing the accounting system in operation for the Department of State's Working Capital Fund. We performed the review primarily during the latter part of fiscal year 1971--the seventh year of the Fund's operations. The review consisted of examining into financial transactions recorded during fiscal years 1970 and 1971, and it also included consideration of the major Fund activities occurring since the Fund was first established in fiscal year 1965.

In addition to a review of the Fund's accounting system, we inquired into and considered Department of State administrative services which had not been included in the Fund. The principal finding of all our work was that the Department has restricted the potential usefulness of the Fund by excluding from the Fund many of the services originally intended to be included, thereby preventing accomplishment of the Fund's intended purpose. We have more fully presented our position on this matter in the letter to which this document is attached.

The weaknesses described below pertain solely to the services included in the Fund at the time of our review. Each weakness has had a further adverse effect on the usefulness of the Fund, and we believe that corrective action is needed if the Department determines that the Fund should be retained.

COSTS CONSISTENTLY EXCLUDED FROM BILLINGS

We found that some of the costs of services included in the Fund have been consistently excluded from Fund billings to the users of the services. This has caused distortion in the costs accumulated in user allotment accounts, which has prevented full achievement of the Fund's objective of promoting cost-consciousness.

One of the ways that costs have been excluded from Fund billings has been the maintenance of billing rates at too low a level to recover all the recorded costs of providing the services. Fund billings for the Despatch Agency and the Motor Pool services, for example, were consistently too low during the four-year period ending with fiscal year 1971 to recover the recorded cost of those services. As a result, the Fund continually operated these two services at a loss totaling about \$336,000 during the four years. The capital of the Fund was not impaired by the losses, however, because the losses were offset by profits earned from other services and from prior-year operations.

Another way that costs have been excluded from Fund billings has been the inclusion in the Fund of only part of the cost of providing services. The reproduction and distribution of airgrams, for example, has been one of the services included in the Fund, but the salary and benefits cost of persons who determine the quantities of specific airgrams to be reproduced and distributed, about \$375,000 during fiscal year 1971, has not been included as part of the airgram service costs. Instead of including these costs in the Fund for subsequent inclusion in the billings for the service, the Department has been charging them directly to an administrative allotment of the Salaries and Expenses appropriation.

Similar exclusions of costs have occurred in the Stock Account, but we understand that this was partially corrected in fiscal year 1972 as a result of an internal audit recommendation.

In our opinion, for each service included in the Fund, all the costs of providing the service should be billed to the users of the service. We believe that partial billings restrict the usefulness of the Fund because partial billings result in distorted records of costs incurred by the users.

Corrective action needed

The Department should ensure that the billing rates of each service in the Fund are maintained at levels permitting full recovery of the recorded cost of providing the service, and that all the costs of each service in the Fund are included in the recorded cost of providing the service.

DEFERRED BILLINGS FOR INCREASED COSTS

We found that the Fund, on occasion, has deferred billings for increased costs. As a result, the costs accumulated in user allotment accounts have not always included all known costs of the services being rendered through the Fund, and consequently, the Fund's objective of promoting cost-consciousness has not been fully achieved.

A major example of deferred billings for increased costs has been the Federal pay raises that have occurred almost annually in recent years. Instead of changing billing rates upon the effective date of a pay raise, the Fund has followed the practice of deferring billings for the increased costs until the Department received its supplemental appropriation to



cover the pay raises. In 1970, moreover, the Fund eventually billed the pay cost increases to a general administrative allotment rather than to the user allotments affected by the increased costs. In 1971, the affected user allotments were billed, but only after the Department had received its supplemental appropriation from the Congress.

We believe that the promotion of cost-consciousness requires that all service cost increases be billed to the users of the services as soon as the cost increases are known.

#### Corrective Action Needed

The Department should ensure that Fund billing rates are promptly adjusted as soon as service cost changes occur, and that the adjusted rates are billed to the users of the services.

#### COSTS BILLED TO NON-USERS

We found that the Fund has been billing some service costs to non-users, thereby preventing the promotion of cost-consciousness on the part of the users of the services. Examples of this practice are discussed below.

#### Airgrams

The Fund has been financing the cost of reproducing and distributing copies of airgrams to various offices, but has not been billing those offices for the service. Instead, the Fund has been billing the cost to the Records Service Division, the organization that analyzes the airgrams to determine the quantity needed by each recipient office. Each recipient office, however, initially specified the number of copies needed, and the Records Service Division looks to these offices for any changes to their established requirements.

During fiscal year 1971, this practice resulted in about \$490,000 of Fund operating costs being billed to the Records Service Division rather than to the users of the service. In addition, as previously mentioned, the annual salary and benefits cost of about \$375,000 for the Records Services Division personnel analyzing the airgrams has been excluded from the Fund.

We believe that the annual cost to analyze, reproduce, and distribute copies of airgrams is significant and warrants the placing of responsibility for justifying the costs on those officials who have the means to control the number of copies needed for distribution. We therefore believe that the total airgram costs should be charged by the Fund to the recipients of the copies rather than to the Records Service Division.

#### Correspondence

The Fund billed the Records Services Division about \$115,000 in fiscal year 1971 for correspondence. This charge represents the cost of preparing form letters to reply to inquiries or requests for information from the general public. The Records Services Division maintains the files related to these inquiries or requests; however, the Bureau of Public Affairs has the mission of providing the public with all information possible consistent with national security requirements. Also, we were informed that staff members of the Bureau of Public Affairs develop language for the form letters processed by the reproduction service. Thus, it would appear that the Bureau of Public Affairs rather than the Records Service Division should be billed for this service.

Freight Forwarding

For simplicity of the billing process, all freight forwarding administrative costs associated with State Department supply shipments processed by the Despatch Agencies are charged to the Supply and Transportation Division rather than to the recipients of the supplies. During fiscal year 1971, these charges amounted to about \$80,000.

Corrective Action Needed

The Department should ensure that all Fund billings are made to the organizations benefiting from the services.

OTHER WEAKNESSES

We found that some of the procedures prescribed in the Fund accounting manual were not being followed.

Financial Management Handbook number 5, dated July 1, 1964, contains the accounting system prescribed for the operation of the Fund and encompasses acceptable accounting principles relating to double entry accrual accounting and reporting. As a result of the General Accounting Office review of the design of the system, several changes were incorporated in the manual to improve the accounting controls. These changes were made by revisions to the manual in December 1964, and March and July 1965.

It is the responsibility of the Department's systems staff to maintain the manual in a current status. However, it is the responsibility of the Fund manager and the accounting staff to assist in recommending additions, deletions or changes as considered appropriate. In the 6 years subsequent to the Comptroller General's formal approval of the system, no changes were made to the manual.

The following are examples of written procedures not being followed.

- The manual provides that quarterly reconciliations be made between the subsidiary perpetual stock account inventory records and the general ledger inventory control accounts. This procedure was not being followed at the time of our review.
- The manual provides for charging monthly to the salary expense account the value of the net change in accrued annual leave. At the time of our review, the accrued leave account was being adjusted only at the end of each fiscal year.
- The manual provides that Despatch Agency transactions for other agencies whose annual transactions are estimated to be less than 25 will be shown as a charge to be billed to OFR. The practice has been to bill all agencies served, regardless of the volume of transactions.
- The manual provides that when requested editing work is contracted with sources outside the Department, the customer will be billed for whatever charges the contractor bills the Fund. The actual practice has been to add a 40 percent surcharge to the contractor's bill.
- The manual provides that to expedite the billing process of the stock account, factors for in-land and ocean freight charges will be added to the cost of the supplies, material or equipment in lieu of waiting for the actual freight charges to be reported. The practice has been to charge the actual freight costs directly to the Department's appropriated funds at the time of payment.

#### Corrective Action Needed

The Department should periodically ensure that the Fund's accounting manual is up-to-date and that all procedures prescribed by the approved manual are being followed.