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Report to the Commander, Air Force Systems Command

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FINANCIAL AUDIT

Financial Reporting and Internal Controls at the Air Force Systems Command

GAO United States General Accounting Office

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January 23, 1991

General Ronald W. Yates
Commander
Air Force Systems Command
Andrews Air Force Base
Washington, D.C. 20332

Dear General Yates:

This report presents the results of our review of the Air Force Systems Command's financial management operations. It addresses internal control and financial reporting improvements needed within the Air Force Systems Command. The report resulted from our examination of the Command's fiscal years 1988 and 1989 financial reporting.

Systems Command managers are responsible for billions of dollars in appropriations and accountable assets. The Command's internal controls and financial reporting, however, are not sufficient to provide adequate and reliable financial information for effective management and reporting of these resources. Our report discusses these problems and recommends corrective actions.

This report contains recommendations to you. We would appreciate receiving a written statement on the actions taken on our recommendations within 60 days of the date of the report.

Also, at the time of our audit, the Contract Management Division was a component of the Systems Command. Subsequent to the completion of our audit work, the Contract Management Division was transferred to the Defense Logistics Agency. Therefore, we are addressing our recommendations relative to the Contract Management Division to the Director of the Defense Logistics Agency.

We are sending copies of this report to the Secretary of Defense, the Secretary of the Air Force, the Director of the Defense Logistics Agency, and other parties who request them.

Sincerely yours,

C. William Moore

C. William Moore
Regional Manager

Executive Summary

Purpose

As part of GAO's audits of the Air Force's financial management and operations for fiscal years 1988 and 1989, GAO evaluated the Air Force Systems Command's internal accounting controls and financial reporting systems. For fiscal years 1988 and 1989, the Systems Command received about $26.7 billion and $32.4 billion, respectively, in appropriated funds. This report discusses the results of our audits of the Systems Command.

Background

The Systems Command is responsible for (1) advancing aerospace science and technology, (2) using these advances to develop and improve operational weapon systems, and (3) acquiring superior and logistically supportable aerospace systems at the most economical cost. This command manages development and acquisition activities in such areas as supersonic aircraft, high-speed computers, stealth technologies, orbiting satellites, and intercontinental ballistic missiles.

Numerous organizations carry out the Systems Command mission. At the time of our audit, the Command had 6 product divisions to perform major procurement activities; 23 laboratories and test organizations to support research, development, test, and evaluation activities; and the Contract Management Division to administer contracts and disburse funds for the development and production of weapon systems.

Results in Brief

Overall, GAO's audit disclosed that the Systems Command needs to strengthen its internal accounting controls and transaction reporting. Specifically, GAO found weaknesses related to the prompt recording of commitments, obligations, and expenditures; reconciling of expenditures with obligations; liability reporting; reporting of contractor debts; contractor recordkeeping and reporting of government owned property; and the accuracy of trial balances. Because of these weaknesses, the Command does not provide its managers and the Air Force Accounting and Finance Center with accurate financial information.

The Systems Command trial balances reported to the Finance Center, for example, contained account balances which were often unsupported, inaccurate and/or questionable. In addition, the trial balances did not include financial transactions of numerous organizations within the Command, including those of the Command's headquarters. Liabilities related to Systems Command's weapon system acquisitions were also not included in the trial balances. These errors and omissions lessened the usefulness of the trial balances to either the Systems Command or the Air Force Accounting and Finance Center.

Principal Findings

Late Recording of Commitments, Obligations, and Expenditures

GAO found that the Systems Command's product divisions were not always promptly recording commitments and obligations in accounting system records. In addition, product divisions did not promptly record expenditures in accounting system records. To the extent Systems Command managers rely on these accounting records to determine if funds are available to support program procurement, late posting of such financial information could result in them committing, obligating, and or expending more funds than were authorized for a program or contract.

Reconciliations Were Not Made

When a paying office, such as the Contract Management Division, makes a disbursement for a Systems Command product division, GAO found that the product division was not always reconciling disbursement transactions with its accounting records. Without these reconciliations, the Command cannot be assured that all disbursements are appropriately recorded against its contracts, and the risk of inappropriate disbursements and inaccurate accounting reports is increased. During fiscal year 1988, GAO found that the Space Systems Division had not performed reconciliations for at least 2 years and that the Aeronautical Systems Division had reconciled data for only 2,000 of its approximately 5,500 contracts.

Inaccurate Liabilities Reported

GAO found that the Contract Management Division overstated liabilities by about $400 million in fiscal year 1988 and by $192 million in fiscal year 1989. These overstated balances were included as accounts payable in the Air Force's financial statements. The overstatements occurred because the Contract Management Division did not reduce the liabilities for payments that had already been made and did not exclude progress payments made to contractors. At the conclusion of GAO's audit, the Contract Management Division was attempting to correct the problem.

Trial Balance Given Low Priority

Financial transactions cause increases and decreases to Air Force asset, liability, and equity accounts. It is a standard accounting practice for organizations to periodically check the accuracy of their recording of transactions by listing and totaling account balances. Such a listing is called a trial balance. A trial balance is an important intermediate step to preparing accurate financial statements. Once prepared, trial balances need to be analyzed to detect accounting errors, questionable account balances, or unexplained variances in account balances.

GAO's review showed that within the trial balances many significant account variances and errors existed which had not been identified by the Command's staff. The staff received the inaccurate and questionable accounting data from Command organizations, consolidated it, and reported the consolidation to the Finance Center. Many of the errors and questionable balances were easily identifiable and should have been questioned and corrected. Because both the Command's reporting organizations and its headquarters gave the trial balances low priority, these errors were not detected. GAO's review led to Systems Command organizations agreeing to make over $20 billion in adjustments, which were necessary to improve the accuracy of the Systems Command 1988 and 1989 trial balances. GAO also found that the March 1988 trial balance prepared by the Space Systems Division was adjusted by $2.4 billion to force it to balance. Division officials could neither support nor explain the adjustment.

Recommendations

The Air Force Systems Command needs to improve its financial management practices. Moreover, it should use generally accepted accounting principles as the primary criteria to guide the Command's accounting practices and financial reporting. GAO is making a number of recommendations which focus on improving

- the timely recording and reconciliation of transactions in the accounting system,
- the accuracy and usefulness of financial reports such as the Contract Management Division's liability report and trial balance,
- the structure of the trial balance report so that it includes the financial activities for all organizations within the Command, and
- Air Force oversight of government owned property to ensure adequate contractor property management and reporting.

Agency Comments

DOD and Air Force officials, in commenting on GAO's principal findings, agreed that trial balances can not be used as a management tool unless they are accurate and reliable. Air Force Systems Command officials stated that as a result of GAO's findings, they have added emphasis to the need for accurate and reliable financial information from Command organizations.

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Abbreviations

AEDC	Arnold Engineering Development Center
AFAFC	Air Force Accounting and Finance Center
AFFTC	Air Force Flight Test Center
AFO	Accounting and Finance Office
AFPRO	Air Force Plant Representative Office
AFSC	Air Force Systems Command
ASD	Aeronautical Systems Division
BSD	Ballistic Systems Division
CMD	Contract Management Division
DCASR	Defense Contract Administrative Services Regions
DIPEC	Defense Industrial Plant Equipment Center
DOD	Department of Defense
ESD	Electronic Systems Division
ESMC	Eastern Space and Missile Center
FAR	Federal Acquisition Regulations
FMFIA	Federal Managers' Financial Integrity Act
GAFS	General Accounting and Finance System
GAO	General Accounting Office
HSD	Human Systems Division
IPE	Industrial plant equipment
MSD	Munitions Systems Division
RADC	Rome Air Development Center
SSD	Space Systems Division

Chapter 1

Introduction

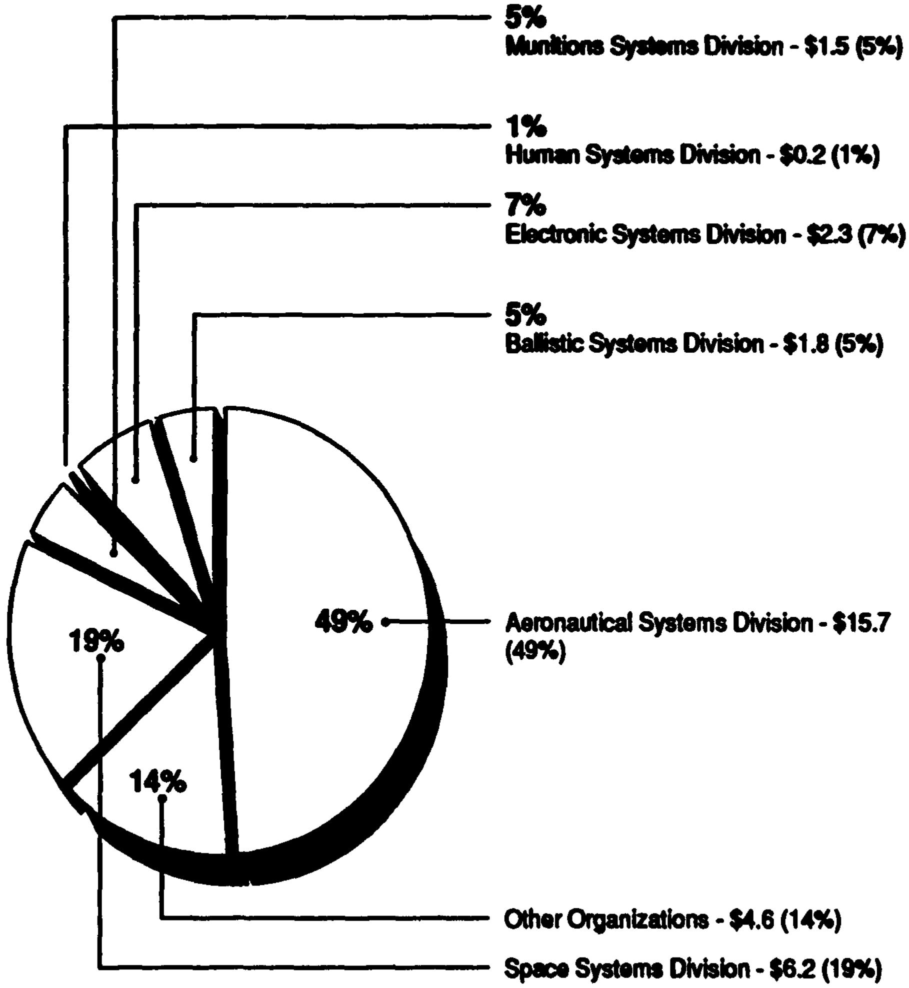
The Air Force Systems Command (AFSC) is responsible for research, development, testing, evaluation, and acquisition of weapon systems for the Air Force. Development and acquisition programs for such items as high-speed computers, supersonic aircraft, intercontinental ballistic missiles, orbiting satellites, aerospace vehicles, and stealth technologies are just some of the programs that AFSC manages.

AFSC is continually challenged to effectively manage its development and acquisition programs. Programs competing for limited resources in an era of large budget deficits, cost growth, extremely long acquisition times, and program stretchouts are problems that AFSC managers must address. To effectively operate in this kind of environment, AFSC managers must have accurate and prompt financial information on which to base resource allocation decisions.

Reliable financial information depends on good internal control systems and timely and accurate financial reporting. With this in mind, we audited AFSC's internal controls and financial reporting for fiscal years 1988 and 1989. As part of our work, we reviewed and evaluated significant internal accounting controls, and performed audit tests to assess the validity and accuracy of account balances reported by AFSC organizations.

The effectiveness of controls over AFSC's financial management operations directly affects the validity and accuracy of the Air Force's financial reports. The Air Force's budget authority was about $95.1 billion in fiscal year 1988 and about $100.4 billion in fiscal year 1989. Of these amounts, AFSC was responsible for about $26.7 billion and $32.4 billion, respectively, or an average of 30 percent of the Air Force budget authority for the 2 years. Figure 1.1 shows how AFSC's funds were allotted within the Command in fiscal year 1989.

Figure 1.1: AFSC's Total Fiscal Year 1989 Appropriated Funds as of September 30, 1989 (Dollars in billions)



Note: AFSC's total fiscal year 1989 appropriated funds amounted to $32.4 billion. However, the dollars in the chart total $32.3 billion because numbers were rounded.

Air Force Systems Command

The AFSC has primary responsibility to (1) advance aerospace science and technology, (2) use these advances to develop and improve operational systems, and (3) acquire qualitatively superior, logistically supportable aerospace systems at the most economical cost. Fulfillment of these responsibilities entails research, development, test, and evaluation of potential aerospace systems (or enhancements to existing systems) and acquisition of reliable and maintainable aerospace systems.

During the course of our audit, AFSC had 6 product divisions to perform procurement activities; 23 laboratories and test organizations to perform the research, development, test, and evaluation; 2 support organizations—the Foreign Technology Division which evaluates and assesses capabilities of foreign technologies and the Contract Management Division (CMD)[1] which oversees contractor performance and pays for goods and services provided by contractors.

The product divisions are responsible for the development and acquisition of various categories of military hardware equipment. The Aeronautical Systems Division (ASD) is responsible for developing and improving aircraft and related equipment. Aircraft developed or being developed by ASD include the B-1B bomber, F-15 and F-16 tactical fighters, and the Advanced Tactical Fighter. The Space Systems Division (SSD) is responsible for the development and acquisition of military space systems such as the Defense Satellite Communications System and the Global Positioning System.

The Electronic Systems Division (ESD) is responsible for command, control, communications, and intelligence systems for the Air Force and other Department of Defense (DOD) agencies. The Ballistic Systems Division (BSD)[2] is responsible for all land-based DOD intercontinental ballistic missile systems. The Munitions Systems Division (MSD)[3] is responsible for a broad range of weapons systems and related equipment. The spectrum of MSD's activities includes such systems as air-launched missiles, guided weapons, mines, aircraft guns, targets, electromagnetic warfare, celestial navigation, and inertial guidance systems. The Human Systems Division (HSD) focuses on the human side of weapons design and development. HSD develops such items as advanced night vision goggles and gravity suits to improve aircrew performance and survivability.

AFSC laboratories are responsible for (1) planning, managing and/or performing research and (2) early development of new technologies related to aeronautical and space systems. AFSC test wings are responsible for testing new technologies developed in the labs or product divisions.

[1]Since completion of our audit work, the Contract Management Division was transferred from AFSC to the Defense Logistics Agency.

[2]Since completion of our audit, AFSC redesignated BSD the Ballistic Missile Organization and made it a part of SSD.

[3]Effective July 1990, AFSC changed the name of MSD to the Air Force Development Test Center.

AFSC activities are financed out of several different types of appropriations: (1) research, development, test and evaluation, (2) procurement, and (3) operation and maintenance. In addition, military personnel and construction appropriations are included in AFSC's budget. Table 1.1 shows the appropriations that made up AFSC's $26.7 billion and $32.4 billion fiscal year 1988 and 1989 budgets.

Table 1.1: AFSC Funding Profile by Appropriation

Dollars in billions

Appropriation	Fiscal year 1988[a]	Percent of total	Fiscal year 1989[a]	Percent of total
Research, development, test, and evaluation	$11.3	42	$13.5	42
Procurement				
Aircraft	6.0	22	9.5	29
Missile	4.2	16	3.8	12
Other	1.6	6	1.6	5
Operation & maintenance	2.1	8	2.3	7
Military personnel, construction, and others	1.5	6	1.7	5
Total	**$26.7**	**100**	**$32.4**	**100**

[a]As of September 30.

Appropriations authorize managers to incur obligations and to make future payments. However, appropriations also control an agency's use of its funds by limiting obligations to maximum amounts, purposes, and time periods. The amounts obligated within the proper period are then paid when debts come due. Appropriations used by AFSC are available for obligation for varying periods. For example, research, development, test and evaluation funds are available for 2 years, procurement funds are available for 3 years, and operation and maintenance funds are available for 1 year.

AFSC Financial Reporting Activities

The Air Force Accounting and Finance Center (AFAFC) prepares the Air Force's consolidated financial statements and reports from information obtained from a variety of sources, such as trial balances and other financial reports prepared by major commands, including AFSC. AFSC and other major commands prepare financial reports by consolidating trial balance reports prepared by their respective activities,[4] such as product divisions, laboratories, and test wings.

[4]AFSC component organizations other than product divisions are referred to as organizations throughout this report.

AFSC allots budget authority to its components for execution of their programs. The components in turn, obligate funds to finance contracts for goods and services. The disbursement of funds under contracts is made by either CMD, the Defense Contract Administrative Services Regions (DCASRs), or other military services who report the disbursements daily to AFAFC. AFAFC then reports these daily disbursements to the Accounting and Finance Office (AFO)[5] for the accountable organization, which is then responsible for ensuring they are properly and accurately recorded against contractual obligations.

At the end of each month, CMD and the DCASRs consolidate disbursements and report them directly to each organization's AFO. The AFOs are supposed to use these monthly reports of disbursement transactions to ensure that their records are accurate. Monthly, CMD also reports liabilities related to AFSC's major weapon system acquisition activities to AFAFC. AFAFC accrues liabilities for Air Force-wide financial reports from CMD's monthly liability reports.

Objectives, Scope, and Methodology

For fiscal years 1988 and 1989, we evaluated the Air Force's financial management operations and its procedures for preparing consolidated financial statements and reports. As required by GAO's accounting standards, the Air Force prepared, for the year ending September 30, 1988, its first set of consolidated financial statements. In February 1990, we issued our report[6] on the results of our audit of those statements. Briefly, we concluded that over 70 percent of the assets included in the Air Force's consolidated statement of financial position were unauditable for various reasons, including internal control weaknesses, lack of integrated financial systems, and absence of adequate historical documentation.

The Air Force did not prepare consolidated financial statements for fiscal year 1989. However, the agency did issue the annual financial reports required by the Department of the Treasury, and we applied our audit procedures to those reports. The overall results of our audit of the 1989 financial reports will be reported separately.

[5]Throughout this report, the activity/office responsible for receiving, disbursing and accounting for public funds and preparing financial reports is referred to as the AFO.

[6]Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990).

During our 1988 and 1989 audit efforts, we evaluated the Air Force's system of internal accounting controls and analyzed year-end reporting at several commands, including AFSC. This report presents the results of our audit activities at AFSC over the 2-year period. Our specific objectives at AFSC were to

- develop an understanding of the AFSC internal control environment;
- identify and document the key internal controls, both manual and automated, that relate to recording, processing, summarizing, and reporting financial data;
- identify and document the information streams of financial transactions from inception of a transaction to the reporting of the information to AFAFC;
- identify and test the internal controls over contract administration and reporting functions;
- evaluate the adequacy and effectiveness of significant internal accounting controls; and
- test events, transactions, and account balances to substantiate their accuracy, completeness, and propriety.

Field work was performed at these sites:

- AFSC Headquarters, Andrews Air Force Base, Washington, D.C.;
- Aeronautical Systems Division (ASD), Wright-Patterson Air Force Base, Ohio;
- Ballistic Systems Division (BSD), Norton Air Force Base, California;
- Electronic Systems Division (ESD), Hanscom Air Force Base, Massachusetts;
- Space Systems Division (SSD), Los Angeles Air Force Station, California;
- Contract Management Division (CMD), Albuquerque, New Mexico;
- Air Force Wright Research and Development Center (WRDC), Wright-Patterson Air Force Base, Ohio;
- 4950th Test Wing, Wright Patterson Air Force Base, Ohio;
- Rome Air Development Center (RADC), Griffiss Air Force Base, New York;
- Air Force Office of Scientific Research, Bolling Air Force Base, Washington, D.C.;
- Air Force Plant Representative Offices (AFPRO), at General Electric Company, Evendale, Ohio; Hughes Aircraft Company, El Segundo, California; and Rockwell International Corporation, Anaheim, California; and
- Foreign Technology Division (FTD), Wright-Patterson Air Force Base, Ohio.

We also gathered information on contractor debts through telephone conversations with contracting officials at 28 AFPROs. In addition, we used written and telephone communications with the following AFSC locations to substantiate the accuracy of AFSC's September 30, 1989, trial balance:

- Air Force Flight Test Center (AFFTC), Edwards Air Force Base, California;
- Eastern Space and Missile Center (ESMC), Patrick Air Force Base, Florida;
- Electronic Systems Division (ESD), Hanscom Air Force Base, Massachusetts;
- Human Systems Division (HSD), Brooks Air Force Base, Texas; and
- Munitions Systems Division (MSD), Eglin Air Force Base, Florida.

The numerous locations selected provided coverage of various types of AFSC activities. Collectively, the AFSC product divisions we visited were responsible for managing and accounting for about 69 percent of AFSC's $26.7 billion fiscal year 1988 budget authority and nearly 73 percent of AFSC's $32.4 billion fiscal year 1989 budget authority.

We reviewed Air Force and AFSC policies relating to financial management and accountability for assets and revenues. We discussed internal controls and financial reporting procedures, functions and processes with managers throughout AFSC. For fiscal year 1988, we tested whether controls ensured that (1) transactions were recorded in the fiscal year in which they occurred, (2) laboratories were tracking costs and billing customers for costs incurred on reimbursable projects, and (3) laboratories and test wings were properly controlling their equipment. Most of the work performed at laboratories and test wings is not discussed in this report. At those locations, we found no material weaknesses in the cost reimbursable and equipment areas. In addition, minor weaknesses found in cost reimbursement were provided in a July 1989 letter report to the Commander of ASD and through a briefing with the Commander of RADC.

For both fiscal years 1988 and 1989, our tests were designed to determine if AFSC's organizations were (1) promptly and accurately recording budget authority, (2) properly authorizing and approving contracts, (3) promptly and accurately recording commitments, obligations, and expenditures, (4) properly and accurately preparing trial balances, and (5) reconciling between source documents and the General Accounting and Finance System (GAFS). At CMD, our tests were to determine if (1) liability reporting was accurate, (2) checks were properly authorized and written for the proper amount, and (3) Treasury checks were properly received and issued.

Our fiscal year 1989 testing included some areas not covered in 1988. These included tests to determine if (1) progress payments were properly authorized, (2) contractor management and reporting of government owned property were properly controlled, (3) contractor debts were being properly reported, and (4) proper procedures were adhered to by CMD in inventorying Treasury checks. In addition, we analyzed AFSC's trial balances and worked with AFSC officials at various locations who, in most cases, determined the dollar amounts of the adjustments needed to correct errors we had found in their trial balances.

We considered previous reports by our office and the Air Force Audit Agency. We also considered AFSC reports prepared for DOD reporting under the Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255). We did not conduct any tests at organizations external to AFSC that administer contracts on behalf of AFSC. These are most commonly DCASRs, the Army, and the Navy.

To evaluate the internal accounting controls and financial reporting of AFSC, we applied GAO's internal control evaluation methodology. This methodology is a risk-oriented approach used to ascertain the amount of reliance that can be placed on a system of internal controls and the quality of data in the financial records.

In performing our audits, for each key control identified, we performed "control tests" of available evidence to ensure that they were, in fact, operating as described by the Air Force. To test controls, we judgmentally sampled procurement contracts, commitment and obligation documents, and progress payments. We also tested the accuracy and reasonableness of account balances for key accounts related to AFSC financial reporting. We did this through variance analyses, physical inventories of selected accountable property and equipment, follow-up on abnormal balances in the trial balance, and review of supporting accounting records for accounts used by AFAFC in preparing the Air Force consolidated trial balance.

In determining what tests to perform, we considered the significance of the internal controls and their importance to substantiating year-end account balances. We then focused our audit work on control policies, procedures, and techniques which we expected to be material to producing accurate financial statements.

We performed our audits in accordance with generally accepted government auditing standards. The audits were conducted from October 1987 through April 1990.

Each chapter of this report discusses our work on specific financial management and internal control functions. Chapter 2 discusses the results of our substantiation of account balances in AFSC's trial balance. Chapter 3 discusses the results of our tests of the internal controls related to the budget, fund control, contract administration, procurement, and disbursement functions. Chapter 4 discusses the results of our tests of contract administration, including CMD's liability reporting, inventory of Treasury checks, and reporting of contractor debt; and AFPRO controls over progress payments and government property.

Financial Reporting: Financial Reports Included Incomplete and Inaccurate Information

Financial transactions cause increases and decreases to asset, liability, and equity accounts. It is a standard accounting practice for organizations to periodically check the accuracy of their recording of transactions by listing and totaling account balances. Such a listing is called a trial balance. Trial balances are prepared before preparation of the financial statements to help ensure that financial statements and financial reports are accurate. Once prepared, trial balances need to be analyzed to detect accounting errors, questionable account balances, or unexplained variances in account balances. The Air Force places a low priority on trial balances. This, coupled with the fact that the standard Air Force system used to account for financial transactions, GAFS, is not based on the double-entry accounting concept means that certain built-in controls that would automatically signal many types of errors do not exist. Add to these circumstances the Air Force's policy which allows fragmented reporting, and the result is incomplete and inaccurate information in Air Force financial reports and statements.

The Air Force Accounting and Finance Center prepares Air Force's consolidated financial statements and reports. The financial statements and reports are prepared from information obtained from a variety of sources, including the trial balances prepared by AFSC. AFSC prepares consolidated trial balances semiannually as of March 31 and September 30 of each fiscal year, based on individual trial balances of select organizations.

We found that the trial balances prepared at the end of fiscal years 1988 and 1989—by both AFSC and its organizations—were substantially incomplete and inaccurate. As a result, the financial reports and statements prepared from these trial balances were inaccurate and unreliable, and managers could not use the reports as tools to manage their operations or evaluate performance.

Many AFSC organizations did not submit their trial balances to AFSC. Instead, they submitted them to other Air Force commands where they were consolidated into those commands' trial balances. Although this practice is permitted by Air Force policy, it distorts the financial information reported in trial balances of AFSC and other Air Force commands.

Our work identified a number of errors which required AFSC organizations to investigate and make a minimum of $20 billion in adjustments to more accurately reflect AFSC's financial condition and operating results for fiscal years 1988 and 1989. These errors occurred, in our view, because AFSC and its organizations did not place high priority on the development of accurate trial balances. Consequently, they did not perform variance analyses or other tests that would have allowed them to detect many accounting errors, questionable account balances, and unexplained variances that we readily noted.

Consolidated Trial Balances Were Substantially Incomplete

Generally accepted accounting principles require an entity with the ability to exert significant control over the policies, management, and funds of subsidiaries or organizational units to include the assets, liabilities, and results of operations for these activities in its consolidated financial statements. While the DOD Accounting Manual (DOD 7220.9-M) requires that only the overall Air Force financial statements be prepared on a consolidated basis, it is our view that AFSC and the other Air Force major commands should include the financial transactions of all their organizations in their consolidated financial reports. First, the American Institute of Certified Public Accountants' Accounting Research Bulletin 51 states that a consolidated presentation of financial transactions is more meaningful than separate financial statements. Second, a consolidated presentation would mean more to AFSC and the Air Force since it would provide a more complete picture of operations, thereby allowing better management analysis and control of resources.

The AFSC trial balances—which provide account balances for financial statements and reports—do not include the results of transactions made by all AFSC organizations. This apparently occurs because the Air Force allows host organizations to include the results of transactions by tenants in their individual trial balances. The host organizations in turn submit these trial balances to their parent organization for consolidation purposes instead of to the parent organization for the tenant organizations. According to AFSC's General and Cost Accounting Division Chief, this practice has been in effect for many years.

The AFSC consolidated trial balance includes accounts for 9 of the 31 AFSC organizations. These are the:

- Aeronautical Systems Division,
- Electronic Systems Division,
- Human Systems Division,
- Munitions Systems Division,
- Space Systems Division,
- Air Force Flight Test Center,
- Arnold Engineering Development Center,
- Eastern Space and Missile Center, and

- Rome Air Development Center.

These organizations received approximately $27 billion of AFSC's fiscal year 1989 appropriated funds and over $21 billion of its fiscal year 1988 appropriated funds.

While the nine organizations received the majority of AFSC's funds, some of the organizations excluded represent significant segments of AFSC's operations. The Ballistic Systems Division, for example, is one of AFSC's six product divisions and manages the development and production of AFSC's intercontinental ballistic missile programs. During fiscal year 1989, BSD received about $1.8 billion or approximately six percent of the AFSC total appropriated funds but its proprietary accounts[1] were reported to the Military Airlift Command. Although this practice was allowed by the Air Force, it understated the results of AFSC's operations and overstated the Military Airlift Command's operations. In addition, it further reduced the usefulness of the trial balances for both commands because neither could use the results to analyze command costs nor plan for, manage, and control resources. In addition, BSD's progress payment transactions were not included in the Military Airlift Command's trial balance since the Command did not report any progress payments. As a result, BSD's progress payments were not reported by either command and were, therefore, excluded from the consolidated Air Force financial statements. BSD's progress payments as of September 30, 1989, amounted to over $617 million.

The consolidated AFSC trial balance also excluded:

- Effects of transactions made by AFSC's headquarters. Although headquarters retained less than one-fourth of a percent of AFSC's total funds (approximately $69 million), it, nevertheless, is an important part of command operations since it manages the AFSC work force along with the billions of dollars in buildings, computers, test equipment, and other assets the command uses. Transactions by the AFSC headquarters operation were included in the consolidated trial balance of the Air Force District of Washington. According to AFSC's General and Cost Accounting Division Chief, this organization manages all Air Force operations within the Washington, D.C., area and prepares the consolidated trial balance for those operations.

[1] Assets, liability, and expense accounts are examples of proprietary control accounts. These accounts provide accounting control over financial resources received from the time an appropriation is received until the applicable resource is consumed, sold, or transferred to other accountable organizations.

- Liabilities reported by CMD. This division's responsibilities include paying contractors and reporting liabilities related to AFSC's major weapon system acquisition activities. CMD, however, reports the AFSC related liabilities directly to AFAFC. Although this is in accordance with Air Force policy, this practice understated AFSC's liabilities by billions of dollars. CMD reported liabilities of $5.5 billion as of September 30, 1988, and $2.5 billion as of September 30, 1989.

Reported Information Was Inaccurate

We found that in addition to the incomplete information included in AFSC trial balances, AFSC and its organizations included materially inaccurate balances in the trial balances. As shown in appendixes II and III, over $20 billion in adjustments were needed to more accurately state the account balances included in AFSC's consolidated fiscal year 1988 and 1989 trial balances.

The Air Force recognizes the need to have accurate trial balances. Air Force Regulation 177-101, General Accounting and Finance Systems At Base Level, states that organizations responsible for maintaining accounting records should (1) ensure that account balances are supported by the detailed records, (2) investigate unusual and unreasonable balances, and (3) make necessary adjusting and correcting entries before the trial balances are prepared. We found, however, that many account balances (see appendix II) reported by AFSC organizations contained significant errors and questionable balances. Further, AFSC staff did not identify or resolve these problems. They received the trial balances from organizational units, consolidated them, and reported the information to AFAFC. This was not in accordance with Air Force Regulation 177-130, which requires major commands to review incoming trial balances for accuracy and completeness and to audit the consolidated trial balances for accuracy.

The trial balance errors generally fell into three categories—those account balances that were (1) abnormal (a credit or negative balance reported for accounts that normally carry a debit or positive balance and vice versa), (2) unreasonable in that they varied significantly from period to period and from organization to organization, and (3) not supported by the detailed records as required by Air Force regulations. In addition, as reported in our February 1990 report, Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources, Space Systems Division's March 1988 trial balance included a $2.4 billion unexplained and undocumented adjustment to its other operating gains and losses account. SSD officials could neither support nor explain the adjustment.

Abnormal Balances Reported

Generally, balances for specific classes of accounts carry normal or predictable balances. Asset and expense accounts, such as accounts receivable and bad debt expenses, normally carry debit balances while liabilities and revenues, such as accounts payable and unearned revenue carry credit balances. Air Force Regulation 700-20, General Ledger and Subsidiary Accounts, provides guidance on normal account balances for Air Force accounts.

We found numerous accounts reported by AFSC organizations to AFSC, and by AFSC to AFAFC, that had abnormal balances. For example, AFSC organizations reported credit balances for accounts receivable, advance payments, construction in progress, and general expense—even though these accounts carry a debit balance. Likewise, AFSC organizations reported debit balances for accrued payroll, accounts payable, deposit fund liability, and unearned revenue. These accounts should carry credit balances.

We found that the abnormal balances, in every case investigated, were erroneous. These errors should have been detected and corrected by the AFSC organizations or by AFSC before AFSC submitted the consolidated trial balance to AFAFC. AFSC personnel responsible for preparing trial balances did not detect or correct these errors, however, because of the low priority they placed on ensuring account balance accuracy.

AFSC organizations reported abnormal account balances totaling nearly $109 million in fiscal year 1988 and $794 million in fiscal year 1989. The mistakes—which were caused by such human errors as the failure to record (1) all transactions, (2) transactions to correct accounts, and (3) the correct amounts—understated AFSC's asset, liability, revenue, and expense account balances. Appendix I lists abnormal balances reported to AFSC by its organizations.

Many of the errors were material in amount. In its September 30, 1989, trial balance, for example, ESD made a $2.2 billion error in the balance reported for general expenses by reporting nearly a $644.7 million credit balance when it should have reported a $1.6 billion debit balance. This error was caused primarily by ESD's failure to properly record all fiscal year 1989 outstanding progress payments. In another example, AFFTC made a $2.6 million error in the amount reported for accrued payroll in its September 30, 1989, trial balance. AFFTC reported a debit balance of $74,000 when it should have reported a credit balance of over $2.5 million.

Large Account Variances Existed

Organizations responsible for maintaining general ledgers are required by regulation to investigate unreasonable amounts and to correct errors before preparing trial balances. However, we found unusually large variances from year to year in a number of AFSC's account balances, which should have been investigated. The following table shows examples of account balances with large variances from year-to-year in the AFSC consolidated trial balances.

Table 2.1: Examples of AFSC Consolidated Account Balances With Significant Changes From Fiscal Year to Fiscal Year

Dollars in billions

Account	September 30, 1987	September 30, 1988	Percent change	September 30, 1989	1988-1989 percent change
Accounts receivable	$0.3	$0.8	166	$0.3	(63)
General expense	21.6	6.1	(72)	9.3	52
Sale of service	1.3	0.5	(62)	1.1	120
Collections	1.6	0.9	(44)	1.7	89
Disbursements	24.4	8.9	(64)	13.7	54

The most significant of these variances was the $15.5 billion decrease in general expenses and the $15.5 billion decrease in disbursements from fiscal year 1987 to fiscal year 1988. Had AFSC officials analyzed these variances, they would have found that one product division (SSD) reported a zero balance for both accounts in its September 30, 1988, trial balance. Such a condition is not possible from an operating standpoint, yet AFSC accepted the zero balances without question. For both accounts, SSD had reported balances over $14 billion a year earlier. These fiscal year 1988 errors occurred because SSD inadvertently reduced the balances to zero before preparing the trial balance.

In addition to large account balance variances, we found other significant variances from period to period at the AFSC organizational level. For example, MSD reported $12.9 million for work in process (progress payments) for fiscal year 1989 compared to $697.6 million for fiscal year 1988, a decrease of 98.1 percent. We requested MSD to investigate the fiscal year 1989 balance. According to MSD's Assistant Director of

Accounting and Finance, that year's balance should have been increased by $358.8 million to $371.7 million. He attributed the fiscal year 1989 error to inexperienced personnel.

We found other inconsistencies in account balances at the organizational level. For example, ESD's September 30, 1988, net investment or net worth account balance which should reflect the Government's investment in ESD, appeared to be grossly understated compared to other AFSC organizations. While ESD received the third largest amount of funds from AFSC during fiscal year 1988 (approximately 8 percent of the total), ESD's reported net worth was only $2.1 million compared to ASD's $7.7 billion and SSD's $3.2 billion. The $2.1 million reported by ESD was less than one-fourth of a percent of AFSC's consolidated net worth of about $16 billion. When asked if the low amount was reported in error, an ESD official, after investigating the matter, concluded that the amount was significantly understated because a number of accounts had been excluded from totals reported over the past few years. Subsequently, ESD officials determined that its net worth as of September 30, 1988, should have been reported as $3.2 billion.

Overall, the most significant variance found, however, related to the amount ASD reported for general expenses. Although ASD received $15.7 billion, or approximately 49 percent of AFSC's total fiscal year 1989 appropriated funds, ASD reported only $269 million for general expenses as of September 30, 1989. This $269 million represented less than 3 percent of $9.3 billion included in AFSC's consolidated trial balance for general expenses. ASD officials told us the $269 million was understated by over $13.7 billion because they had inadvertently excluded the cost of weapon systems they purchased. While these costs from an accounting standpoint should be capitalized since they involve property that will be used over several accounting periods, ASD treats them as expenses of each accounting period per Air Force direction, in order to avoid duplicating weapon system costs at the Air Force level. As we reported in our report, Financial Audit: Air Force Does Not Effectively Account for Billions of Dollars of Resources, the Air Force Logistics Command is responsible for valuing and reporting the weapon systems included in the Air Force's consolidated financial statements.

Account Balances Were Not Supported by Required Documentation

To minimize errors, account balances should be supported by reliable documentation. Air Force Regulation 177-101 requires organizations to ensure that account balances included in the trial balance are supported by detailed records. However, we found that several reported balances were not supported by detailed records. For example:

- AFSC's consolidated trial balance did not accurately record the cost of the 12 Air Force-owned industrial plants operated by contractors. Although ASD, the organization responsible for accounting for the plants, had reported their value at $732 million as of September 30, 1989, this amount was erroneous and not documented. ASD analyzed the account, at our request, to verify the accuracy and determined that the balance should have been $876 million and, therefore, was understated by over $144 million. After our inquiry, ASD found a report which contained the historical cost of the plants and subsequently adjusted the account balance.
- SSD reported $7.4 million for certain equipment and nearly $202,000 for material on hand in its fiscal year 1989 trial balance. Neither amount was supported by detailed records. Although the appropriate SSD unit prepared the required reports which contained the correct amounts for the two accounts, the reports were not used to update the trial balance because the AFO did not furnish them to the unit responsible for preparing the trial balance. This oversight resulted in a net overstatement of $2.6 million, or 53 percent. The correct total for these two accounts should have been less than $5.0 million.

Accuracy of Trial Balances Was a Low Priority

Air Force Regulation 177-101 requires organizations responsible for maintaining accounting records to ensure trial balance accounts are accurate and supported by detailed records. Air Force Regulation 177-130 also requires major commands, such as AFSC, to ensure that trial balances are accurate. In order to fulfill these requirements, AFSC and its organizations must review all accounts at the end of each reporting period. However, neither AFSC nor its organizations gave sufficient management attention to the trial balances.

We noted many erroneous and questionable AFSC account balances as discussed earlier. We believe that if AFSC management at the various organizational levels had performed a review of the account balances, all of the problems we noted would have been detected and corrected. However, AFSC officials did not emphasize the importance of the trial balances or their usefulness. Consequently, these officials placed a low priority on their preparation, analysis, and accuracy. For example, ASD accounting and finance officials told us they did not give the trial balance high priority because they did not know "if" or "how" it was used. Similarly, AFSC's General and Cost Accounting Division Chief acknowledged that AFSC did not place a high priority on trial balances. According to him, AFSC did not analyze the trial balances but consolidated them and forwarded the consolidated report to AFAFC. This statement is supported by the fact that one AFSC organization reported a balance for a non-existing general ledger account for both fiscal years 1988 and 1989 and the errors remained uncorrected for some time after AFSC had forwarded the consolidated trial balances to AFAFC. AFAFC notified AFSC that the errors needed to be corrected.

AFSC's failure to follow up promptly on erroneous and questionable account balances resulted in inaccurate account balances being forwarded to AFAFC for inclusion in the overall Air Force financial statements. Our work showed that over $19 billion in adjustments were needed to improve the accuracy of AFSC's fiscal year 1989 trial balance. Appendixes II and III provide details of these adjustments.

Despite the problems noted, AFSC comptrollers for product divisions told us they place a high priority on trial balance preparation. They attributed the problems we noted to high personnel turnover, unclear accounting guidance, and inadequately trained personnel. The headquarters AFSC Comptroller also said that the AFSC had taken steps to increase the emphasis given trial balances since preparation of the fiscal year 1989 trial balances. Among other things, a checklist has been developed for preparing and analyzing trial balances. The AFSC Comptroller said trial balances when accurately and reliably prepared can assist in decision-making.

Conclusions

Trial balance information should be useful in managing operations and evaluating performance. This can only happen, however, if the trial balances contain complete, accurate, timely, and relevant information.

The AFSC consolidated trial balance excluded account balances of some of its organizations. This practice resulted in part because the Air Force allows transactions made by tenant organizations to be reported in host organizations' trial balances. Although this is an Air Force practice, it distorts the results of AFSC's operations as well as those of other major commands.

In addition, we found that the trial balances of AFSC and its organizations included significantly inaccurate balances. Our work showed a minimum of $20 billion in adjustments were needed to more accurately state account balances for fiscal years 1988 and 1989. Many of the errors were obvious and should have been detected by reviewing the account balances. Because of the low priority AFSC placed on trial balance preparation, review and analysis, however, the errors remained uncorrected and stayed in trial balances submitted to AFAFC for preparation of the consolidated Air Force trial balance.

Recommendations

We recommend that the Commander of the Air Force Systems Command direct the Air Force Systems Command's Comptroller to

- ensure that account balances of all Air Force Systems Command organizations and activities are included in the consolidated trial balances and
- enforce Air Force policy and regulations requiring trial balances to be accurate, complete, and supported by reliable documentation.

Financial Operations: Internal Controls Need Improvement

Weapon system acquisition programs are funded by budget authority, usually appropriations, and are allotted portions of these appropriations throughout the year. These allotments give a program office the authority needed to obligate funds for research, development, or production of a weapon system. Besides the budget authority, a program office must also receive and follow specific acquisition program guidelines which are usually included in a Secretary of the Air Force program management directive or other authorization document. After budget authority and program direction are received, the program office initiates contracts; verifies that potential contractors are not on the list of debarred, suspended, or ineligible vendors; and awards the contracts.

To effectively manage the billions of dollars in weapon system acquisition programs, AFSC needs assurance that procurements are properly authorized and that the standard accounting system, the General Accounting and Finance System, provides consistent, prompt, and reliable financial management information. Our control tests of the financial management information were performed at three product divisions (Aeronautical Systems Division, Electronic Systems Division, and Space Systems Division) and the Rome Air Development Center for fiscal year 1988 and at ASD, SSD, and the Ballistic Systems Division for fiscal year 1989. We found that AFSC controls over authorizing contracts and recording obligations in the appropriate fiscal years were adequate at all five locations. However, we found that AFSC had weak controls over prompt recording of (1) authority to obligate funds, at one location, (2) commitments that will result in future outlays of funds at two locations, (3) obligations for contracts awarded and similar transactions at three locations, and (4) expenditures or payments of obligations at all five locations. In addition, we found that four accounting and finance offices were not routinely reconciling expenditures recorded in GAFS with paying office and manual records.

As a result of these weak controls, GAFS does not provide AFSC managers with timely and accurate financial information. This increases the risk that

- AFSC managers, in making procurement decisions, can be misled concerning the availability of funds for commitment, obligation, or expenditure; and
- AFSC program managers and others will develop systems or sources of information to compensate for the late and incomplete financial information in GAFS.

Tests Indicate Controls Over Contract Authorizations Are Working as Intended

We reviewed 215 contracting actions during our testing (52 original contract awards and 131 contract modifications made by ASD, ESD, and SSD during fiscal year 1988 and 32 contracts awarded by ASD, BSD, and SSD during fiscal year 1989). During both years, we tested for (1) proper authorization, (2) compliance with selected regulations, and (3) eligibility of the contractor to receive the contract or modification. Our tests showed that controls over weapon system contract authorization and approval were working as intended. We found two items, however, which deserve AFSC's attention.

We found the product divisions inconsistently documented efforts undertaken to ensure that contracts and modifications were given only to eligible vendors. Federal Acquisition Regulation (FAR) Section 9.103 requires contracting officers to make an affirmative determination of a contractor's responsibility, including eligibility for the award of a contract, before a contract is awarded. FAR Section 9.105 states that one of the sources of information that should be used to support determinations of responsibility is the consolidated list entitled Parties Excluded From Procurement Programs. This list of ineligible vendors is published by the General Services Administration. FAR Section 9.405 states that contracts shall not be awarded to or renewed with contractors on this list unless the acquiring agency's head or designee determines that there is a compelling reason for such action.

While the FAR does not contain a specific requirement that the contracting officer document verification of contractor eligibility, we believe that such documentation strengthens the effectiveness and consistency of the process and provides a record of the determination. ESD required the contracting officer to prepare and sign a specific document—for both original contracts and contract modifications—stating that the contractor was not on the list of debarred, suspended, or ineligible contractors. SSD also followed this practice but only for original contracts because SSD officials believed the eligibility determination was satisfied with awarding of the basic contract. Unlike ESD and SSD, ASD and BSD did not document contractor eligibility. ASD's policy, however, states that the contracting officer, when signing the contract, attests that the contractor meets eligibility.

In addition to inconsistent documentation of efforts to ensure contracts were awarded to eligible vendors, we found that product divisions did not always cite the program management directive or other authorizing documents on requests for contractual actions or purchase requests, as required by the joint Air Force Logistics Command and AFSC Regulation

57-7. ASD and BSD cite authorization documents on all purchase requests. ESD does not cite the authorization documents for any contracts or contract modifications, and SSD does not cite them for contract modifications. Citing the authorization on purchase request forms is a good control technique, which helps ensure that each request has been properly authorized. Different interpretations of the joint regulation by the product divisions, however, apparently led to the inconsistent practices we observed.

Budget Authority, Commitments, and Obligations Were Not Always Promptly Recorded

Within the Air Force, budget authority is allotted from Air Force headquarters to major commands and on to command organizations. At each level, budget authority may be used for commitments and obligations. Commitments are administrative reservations of funds for future procurement requests and other requirements. Obligations represent amounts of orders placed, contracts awarded, services received and similar transactions that will require payments.

GAFS, the standard Air Force system used to account for all financial transactions, primarily accounts for the allocation and use of appropriated funds. The system helps to ensure that program managers do not inadvertently obligate more funds than are available.

Our audits of financial transactions for fiscal years 1988 and 1989 showed that accounting transactions which established budget authority and committed and obligated funds as a whole, were recorded accurately in the accounting system. As discussed in the following sections, however, we found some instances of internal control weaknesses.

ESD Did Not Promptly Record Budget Authority

In fiscal year 1988, we reviewed budget authority at three divisions (ASD, ESD, and SSD) and at Rome Air Development Center to determine whether authorized budget allotments had been accurately and promptly recorded in the accounting records. We (1) verified that selected budget authority documents approved by AFSC were received and filed appropriately, (2) compared about 70 budget authority entries to source documents at each of the four organizations to check for accuracy and promptness of the transactions, and (3) matched the accounting system budget authority amounts reported at fiscal year-end with final fiscal year 1988 budget documents. These tests did not disclose any significant weaknesses in controls over budget authority, with the exception of late recording of transactions at ESD.

ESD's goal is that budget authority be recorded in GAFS within 3 days from the date of the source document. We found that 362 of 557 (65 percent) budget authority entries we tested at ESD were not recorded that soon. In fact, we found that approximately 47 percent were not recorded within 7 days of the source document date. Late entry of budget authority reduces the accuracy of reports to AFSC managers. This in turn may result in managers believing (1) funds are available although authority has been withdrawn or utilized or (2) funds are not available even though authority has been provided.

Commitments and Obligations Were Not Promptly Recorded

During our fiscal year 1988 tests, we reviewed commitment and obligation documents at each of the three product divisions and the Rome Air Development Center to determine if they were recorded accurately and promptly. To test for accuracy, we compared the fund citations and dollar amounts in the accounting system with the source documents in AFO contract files. While these tests showed transactions were recorded accurately, tests for promptness identified weaknesses at SSD and ESD.

To test for timeliness, we compared dates on commitment and obligation documents to the dates the transactions were recorded in GAFS by AFOs. Our criteria for promptness were the goals established by each of the units being tested—5 days except for SSD which had a goal of 7 days. The results of transactions tested follow.

- At ESD, only 72 percent (152 of 211) commitments and 39 percent (65 of 165) obligations were recorded within 5 days of receipt.
- At ASD, 93 percent (54 of 58) of commitments and 88 percent (56 of 64) obligations were recorded within 5 days of receipt.
- At the Rome Air Development Center, 38 of 39 commitments and 43 of 43 obligations were recorded within 5 days of receipt.
- At SSD, only 64 percent (114 of 179) of commitments and 65 percent (131 of 202) of obligations were recorded within 7 days of receipt.

Because 61 percent of the obligations were recorded late at ESD, we reviewed them in more detail to determine how extensive the delays were. The following table shows the results of our aging of 91 obligations (totaling about $363 million) which were not posted within ESD's 5-day goal.

Table 3.1: Obligation Recording Times at ESD

Days before recording	Number of obligations	Dollar value (millions)
6-10	37	$107.4
11-20	30	16.6
21-50	14	235.0
51-100	3	0.1
over 100	7	4.0

Based on this additional analysis, it was apparent that ESD had problems promptly recording obligations. Both ESD and SSD officials said that these problems were caused by a shortage of personnel. Although our audit did not address staffing, we noted both of these locations experienced many turnovers and vacancies.

For fiscal year 1989, we also reviewed the timeliness of obligation entries but on a more limited scale. In these tests, we reviewed obligation documents for expenditures at each of three locations (ASD, BSD, and SSD). We selected 7 days as the criterion because this was the longest time allowed by any activity we had previously reviewed.

As shown below, test results for ASD and SSD were similar to what we found in our fiscal year 1988 tests. We did not review the timeliness of obligations recorded for fiscal year 1988 at BSD. However, our fiscal year 1989 tests at BSD showed timeliness problems similar to those at SSD. Specifically, we found:

- At ASD, 9 of 11 (82 percent) obligations reviewed were entered within 7 days of receipt.
- At SSD, 6 of 9 (67 percent) obligations were entered within 7 days. In one case, we could not determine when the entry was made.
- At BSD, 5 of 9 (56 percent) obligations reviewed were entered within 7 days of receipt.

Late recording of commitments and obligations affects the accuracy of AFSC's financial records and resultant reports. To the extent program managers rely on these reports to commit and obligate funds, inaccurate reports could cause them to overobligate funds, possibly in violation of the Antideficiency Act, or to allow properly available funds to lapse, becoming unavailable for use by AFSC.

Tests Show AFSC Recorded Obligations in the Proper Fiscal Year

Appropriations managed by AFSC are available for obligations for varying periods. Research, development, test and evaluation funds are available for 2 years, procurement funds are available for 3, and operation and maintenance funds are available for 1. With these limits in mind, we tested 32 contract actions awarded by three product divisions (ASD, ESD and SSD) during the last 16 days of fiscal year 1988 to determine whether obligations made were recorded and reported in the proper fiscal year. Specifically, we verified that the (1) contracts were awarded before October 1, 1988, (2) commitment documents were issued before the contract was awarded, and (3) fund citation on the obligation document agreed with the commitment document. We found no exceptions.

In addition, we tested a sample of 36 contract actions awarded during the first 15 days of fiscal year 1989 to ensure that expired funds were not used and that the obligations were not erroneously recorded in fiscal year 1988 records. These tests also disclosed no discrepancies.

Expenditures Were Not Properly Classified Nor Promptly Recorded

During our tests for fiscal years 1988 and 1989, we found material weaknesses relating to the prompt recording of expenditures. These weaknesses affect the accuracy of accounting reports and mislead AFSC managers concerning the amount of unliquidated obligations. Similar weaknesses exist elsewhere in the Air Force.[1]

To determine how accurately and promptly expenditures were recorded in the accounting system, we tested 278 fiscal year 1988 transactions and 30 fiscal year 1989 transactions. The fiscal 1988 transactions consisted of 70 each at four AFOs which supported three product divisions[2] (ASD, ESD and SSD) and the Rome Air Development Center. The 30 expenditures for fiscal year 1989 were obtained from the 3 AFOs which support ASD, BSD, and SSD. For both years, we (1) traced the amount recorded and the accounting classification to source documents and (2) reviewed the number of calendar days from the time AFAFC sent the transaction to the AFO until the AFO recorded it in the accounting system. During our review of fiscal year 1989, we also measured the number of days in the earlier stages of the payment cycle—from payment by the Contract Management Division through AFAFC processing. We did this to

[1] Air Force Does Not Effectively Account for Billions of Dollars of Resources (GAO/AFMD-90-23, February 23, 1990).

[2] We were unable to complete our tests on two expenditures at ESD because we could not determine when the transactions were recorded in the general accounting and finance system.

determine where delays were occurring. For both years, we identified weaknesses in the prompt recording of expenditures. While we did not find problems with accuracy during our fiscal year 1988 tests, we did find accounting classification accuracy problems in fiscal year 1989.

Expenditures Were Misclassified

Proper classification of transactions is necessary for reliable financial records and reports. During our fiscal year 1989 review of expenditures, however, ASD's AFO officials told us that progress payments made using "M" accounts[3] were being automatically recorded as expenses. Progress payments should be recorded as assets since (1) the government obtains title to all work in process, finished goods, and other property for which progress payments are made and (2) property is not expected to be consumed or expensed during a specific accounting period.

We found that the erroneous recording was caused by the failure of the computer program at AFAFC to assign the progress payment code to "M" account funded progress payments as it did for other years' progress payments. Without this assignment, GAFS at AFOs automatically and incorrectly processes progress payments as expenses.

To correct this, accounting technicians must reverse the erroneous entries and manually re-enter the corrected transactions, including the proper code. Failure to do so allows management reports for internal product division use and for reporting to AFSC to remain inaccurate. This, in turn, results in the trial balance understating assets and overstating expenses on the overall Air Force financial statements and reports.

According to ASD officials, identifying and correcting these progress payments is time-consuming for the accounting technicians and does not ensure that all misclassified progress payment transactions will be identified. We contacted AFAFC and explained the negative impact on product divisions' workload and accounting accuracy of not recording the proper code for "M" account payments. AFAFC officials agreed to revise the software so that "M" account progress payments will be properly coded. According to ASD officials, this should improve the accuracy of the

[3]M accounts contain the merged, unexpended balances of obligations made against appropriations which expired on or before September 30, 1988. Under Public Law 101-510, November 5, 1990, unexpended obligations made against appropriations which expire after fiscal year 1988 will no longer be added to M accounts, and current M account obligated balances will be canceled by September 30, 1993.

accounting records and reports while significantly reducing the work load of the accounting technicians.

Expenditures Were Not Promptly Recorded

To ensure that managers receive accurate information regarding the amount of funds that have been expended, expenditures must be promptly recorded in GAFS. During our tests, we found neither AFSC nor the Air Force had criteria for the number of calendar days it should take for AFOs to record expenditures. For determining promptness, our criterion was 10 calendar days from the date AFAFC sent the transactions to AFOs until those offices recorded the transactions in GAFS. This criterion is reasonable because (1) AFAFC electronically transmits expenditure data daily, (2) recording transactions is generally not a time-consuming process—AFOs record the data directly from the electronic tape provided by AFAFC, and (3) the product divisions and the Rome Air Development Center use either 5 or 7 calendar days as criteria for recording commitments and obligations.

1988 Expenditure Transactions

Of the 278 fiscal year 1988 expenditures tested, 214 (77 percent) were not recorded within 10 days. The following table shows the detailed results of our 1988 tests.

Table 3.2: Expenditure Recording Times for Fiscal Year 1988

Location	Number tested	Number recorded within 10 days	Number recorded after 10 days	Range for those exceeding 10 days
ASD	70	35	35	12–80 days
ESD	68	19	49	11–123 days
RADC	70	6	64	11–35 days
SSD	70	4	66	11–353 days
Total	**278**	**64**	**214**	

As shown by table 3.2, SSD took substantially longer to record expenditures than did the other locations. Consequently, we expanded our analysis at that location. This additional analysis showed that SSD had over 2,900 expenditures totaling almost $951 million that had been received from AFAFC during fiscal year 1988 but had not been recorded as of September 30, 1988. Nearly 500 of those expenditures, with an approximate value of $157 million, had been sent to SSD at least 9 months earlier.

SSD had attempted to record 516 of the 2,900 expenditure transactions totaling $282 million, but the transactions were rejected by the accounting system for undetermined reasons. The SSD's AFO had not researched these expenditures to determine the specific reasons why the transactions were rejected. This research should have been done so that the expenditures could either be recorded against the proper obligations at SSD or returned to AFAFC for resolution. SSD officials attributed this large backlog of unrecorded expenditures to computer processing problems and staff shortages in the AFO.

1989 Expenditure Transactions

For fiscal year 1989, we noted that SSD had significantly reduced its backlog of unrecorded expenditures. As of September 30, 1989, SSD had approximately 500 unprocessed transactions with a value of about $153 million. SSD officials said they were able to achieve this reduction through overtime and temporarily bringing in AFO employees from other AFSC locations. Still, our tests for fiscal year 1989 confirmed the 1988 results showing SSD and other divisions were still not promptly recording expenditures.

Table 3.3: Expenditure Recording Times for Fiscal Year 1989

Location	Number tested	Number recorded within 10 days	Number recorded after 10 days	Range for those exceeding 10 days
ASD	11	3	8	15–69 days
SSD	10	1	9	14–212 days
BSD	9	2	7	11–14 days
Total	**30**	**6**	**24**	

Our fiscal year 1989 tests also confirmed that delays occur at AFOs. Specifically, CMD transmitted disbursement records to AFAFC, which generally processed the transactions and transmitted them to the AFO within 5 days. AFOs, however, did not promptly record the expenditures in GAFS. As shown in table 3.3, AFOs did not promptly record 80 percent of the cases we tested.

Late recording of expenditures could result in several problems. By not promptly recording expenditures against the proper obligations or reconciling the mismatches between expenditures and obligations, unliquidated obligation balances for contracts throughout AFSC could be overstated and remain so until payment is posted.[4] This could lead AFSC managers to believe that they have more funds available for expenditure than actually exist. This, in turn, could conceivably result in violations of the Antideficiency Act.

Late recording also increases the risk that AFSC product divisions would not receive prompt and accurate cost information about the programs they manage. The inaccurate and late information adversely effects the usefulness of financial reports prepared for AFSC managers as well as other organizations such as the Air Force, DOD, and Treasury.

Expenditures and Unliquidated Obligations Were Not Adequately Reconciled

In addition to not promptly recording expenditures, we found that AFSC did not have adequate controls to ensure that AFOs reconcile expenditure information in GAFS with (1) manual accounting records they maintain and (2) expenditure records maintained by CMD and other paying organizations. Both of these reconciliations are required by Air Force regulations to ensure that expenditures are charged to the proper obligation and do not exceed the obligated amounts. Charges to the wrong obligation would cause unliquidated obligation balances to be misstated.

Because of the large number of expenditure transactions processed by the paying offices and AFOs, effective controls are needed to detect charges of expenditures to the wrong obligation or contract. For example, we found 12 cases where, according to GAFS, the payments charged by the paying office to a specific fund citation on a contract exceeded the amounts obligated. The amount of these over-expenditures ranged from $778 to almost $1.5 million. Without reconciliations, such mistakes are unlikely to be detected, and overpayment would not be identified and collected.

Paying Office and Accountable Office Records Were Not Reconciled

To ensure that disbursements are recorded against the appropriate obligations, Air Force accountable AFOs should reconcile their accounting system records with the disbursement records maintained by the paying office. To facilitate this, the paying office must send a monthly 7140 report to each accountable AFO. This report lists, by contract and appropriation, the amount obligated and the unliquidated obligation balances. During our testing of expenditures, we found that AFOs were generally

[4]Numerous problems may cause inaccurate obligation and expenditure balances on contracts. For a more detailed discussion, see our report Air Force Records Contain $512 Million in Negative Unliquidated Obligations, (GAO/AFMD-89-78, June 1989).

not reconciling the expenditures listed on the 7140 reports with the information in the accounting system, as required.

As described below, we found that reconciliations were given a low priority at three locations, during fiscal year 1988, while they were routinely performed at the Rome Air Development Center.

- At ESD, officials told us that reconciliations are performed only when contracts are closed out or when they become aware of a discrepancy. They said reconciliations are a low priority, considering ESD's ability to attract and retain qualified personnel. During our tests, we found 35 instances (out of 68 expenditures tested) where unliquidated obligation balances in the accounting system did not match the 7140 report.
- At SSD, an AFO official said reconciliations with 7140 reports had not been made for at least 2 fiscal years and added that any attempt to reconcile would be futile because of the large backlog of expenditures which had not been recorded.
- At ASD, officials said reconciliations are done as time permits. As of late September 1988, ASD had only reconciled about 2,000 of its 5,500 open contracts.
- At the Rome Air Development Center, officials said reconciliations are routine. Although we found four instances (out of 50 expenditures tested) where unliquidated obligation balances in the accounting system did not agree with the 7140 reports, officials were aware of them and were correcting them.

AFOs Did Not Adequately Reconcile Manual and Automated Disbursement Records

Air Force Regulations 170-8 and 177-101 generally require unliquidated obligation balances to be reconciled quarterly to supporting documents. Such reconciliations help ensure unliquidated obligation balances are accurate.

AFOs maintain two types of disbursement records—one automated and one manual. The automated records in the accounting system provide the funding status for each contract: obligations, expenditures, and funds available for expenditure. The manual records are contract files maintained by the accountable office, which include obligation and expenditure documents and a current balance of unliquidated obligations.

We reviewed the automated and manual records maintained by ESD, SSD, ASD, and the Rome Air Development Center during our fiscal year 1988 audit and found two of these organizations were not adequately performing these reconciliations. As a result, our tests showed differences in the unliquidated obligation balances. Following are the results of our fiscal year 1988 testing.

- At ESD, the manual and automated balances did not agree in 19 of the 68 cases tested. For example, in one case the balance of unliquidated obligations in the manual records was $1,130,849 and the automated record balance was $1,460,849—a difference of $330,000.
- At SSD, the balances did not agree in 45 of 70 cases. For example, in one case the manual file showed a negative unliquidated obligation balance of $589,822, whereas the automated records showed a negative balance of $947,808—a difference of $357,986. An AFO official said about 40 percent of the unliquidated obligation balances in the accounting system as of September 30, 1988, did not agree with the manual files. The official also said no attempt was made to reconcile the differences because technicians at SSD were far behind in recording expenditures in their manual records.
- At ASD, the balances agreed in all 43 cases tested.
- At the Rome Air Development Center, the balances agreed in all 70 cases tested.

During our fiscal year 1989 audit, we also examined the automated and manual records to determine whether reconciliations were being performed as required. Specifically, we determined whether the manual records related to the expenditures in our sample were being reconciled to the 7140 reports and to the listing of balances within GAFS. We found AFOs for the product divisions were not consistently performing the required reconciliations.

- At BSD, the manual records for three of the nine expenditures sampled had not been reconciled in the preceding 6 months. All nine had been reconciled within the last year.
- At ASD, the manual records for six of the eleven expenditures sampled had not been reconciled in the preceding year.
- At SSD, the AFO compared automated and manual records for about 75 percent of the unliquidated obligations and found that the records did not agree in about 36 percent of the cases.

Conclusions

AFSC manages billions of dollars in weapon system acquisition programs. To help ensure the integrity and reliability of financial information, promote conformity with proper operating procedures, and safeguard assets, AFSC needs strong systems of internal controls. Failure to have effective controls could result in AFSC managers being misled concerning the availability of funds for commitments, obligations, and expenditures.

Based on our work, we found that AFSC controls over some areas, such as authorizing contracts and recording obligations in the appropriate fiscal year, were generally working as intended. However, we found that AFSC controls over other significant areas need improvement. First, commitments and obligations were not being promptly recorded. To the extent program managers rely on GAFS financial reports to commit and obligate funds for procurements, they could be misled into inadvertently obligating more funds than are available (possibly in violation of the Antideficiency Act) or allowing available funds to lapse. Second, we found that while proper classification of transactions is necessary for reliable financial records, some transactions were being improperly classified.

In addition, for both fiscal years 1988 and 1989, we found material weaknesses relating to the prompt recording of expenditures. Over 75 percent of the 308 expenditure transactions we tested had not been promptly recorded. Failure to maintain current and accurate financial information in the accounting system significantly affects its usefulness to all levels of AFSC management. Finally, we found that AFSC does not have controls to ensure that AFOs reconcile expenditures to manual accounting records and to records maintained by paying organizations as required by Air Force regulations. Weak controls in this area could also result in expenditures being made in excess of obligations.

Recommendations

We recommend that the Commander of AFSC

- require AFSC product divisions to identify the appropriate authorization document on each purchase request and
- require AFSC product divisions to document the determinations of contractors' eligibility.

Also, we recommend that the Commander direct the Comptroller to

- ensure that commitments, obligations, and expenditures are promptly recorded in the Air Force GAFS and

- ensure that AFOs promptly conduct required reconciliations of disbursements and obligations and follow up on differences.

Contract Administration: Internal Controls Need Strengthening

The Contract Management Division[1] is the primary Air Force organization responsible for monitoring and administering contracts at contractor plants. CMD's basic mission is to oversee contractor performance and to pay for goods and services provided by AFSC contractors. In this regard, CMD (1) evaluates contractor management systems, (2) assesses compliance with contractual requirements, (3) provides support to AFSC buying activities, and (4) validates contractor invoices for payment.

CMD also provides guidance to its 29 Air Force Plant Representative Offices. AFPROs are located at major contractor plants and are responsible for providing on-site contract oversight and administration such as (1) approving or disapproving contractor procurement and cost estimating systems, (2) monitoring contractor financial conditions, (3) approving or disapproving contractor requests for progress payments, (4) monitoring and evaluating contractor production plans and schedules, and (5) administering government property contract requirements.

Our tests showed that controls at CMD and the AFPROs need strengthening. At CMD, our tests disclosed weaknesses in the (1) reporting of liabilities, (2) procedures for inventorying Treasury checks, and (3) reporting of contractor debt. And, at the AFPROs, we found weak controls over both progress payments and government property.

Contract Management Division Has Basic Internal Control Weaknesses

CMD's primary accounting and financial reporting responsibilities include reporting to AFAFC (1) payments made to contractors and (2) Air Force-wide liabilities related to AFSC's major weapon system acquisition activities. Usually, the payments and liabilities are for development or production of major items such as aircraft, missiles, engines, and electronic components.

CMD administered about 29,000 contracts and paid about $21.2 billion to contractors during fiscal year 1988. During fiscal year 1989, CMD administered approximately the same number of transactions and paid approximately $20.3 billion.

Because of the large volume of transactions and payments processed by CMD in fiscal years 1988 and 1989, we examined the internal controls

[1] As noted in chapter 1, the Contract Management Division is now a component of the Defense Logistics Agency. Information presented in this chapter relates to the operating processes, procedures, and controls that existed at the time of our audit.

over CMD's contract payment functions. Specifically, we reviewed controls over the (1) accuracy of liabilities reported to AFAFC, (2) receipt and distribution of checks from and to contractors, (3) authorization and accuracy of payments to contractors, and (4) accuracy of contract data in the Acquisition Management Information System.[2] For fiscal year 1989, we expanded the scope of our audit to include a review of controls over other areas, including CMD security over its inventories of unissued Treasury checks.

On the basis of our examination, we found that (1) liability reporting was inaccurate, (2) procedures for conducting surprise inventories of Treasury checks were inadequate, and (3) contractor debts were not always reported to CMD by contracting officers at the AFPROS.

Inaccurate Liabilities Reported to Air Force Accounting and Finance Center

As part of our tests of CMD's controls over financial reporting, we reviewed the accuracy of CMD's reporting of accrued unpaid expenditures (liabilities) to AFAFC. Procedures followed in doing this work included (1) a review of CMD's September 1988 and September 1989 liability reports, (2) discussions with CMD officials about report preparation and content, and (3) an examination of the computer program specification package which describes how the Acquisition Management Information System produces its accrued expenditure unpaid summary.

According to Air Force Regulation 177-120, liabilities represent amounts owed for goods and services received as well as holdbacks[3] on progress and cost reimbursement payments. Our tests showed CMD overstated its fiscal year 1988 liabilities by about $400 million. This, in turn, caused liabilities on the Air Force consolidated financial reports to be overstated. The overstatement occurred because (1) CMD did not reduce its liabilities by approximately $1 billion for payments which had already been made and (2) CMD erroneously excluded $600 million in liabilities for progress payment holdbacks.

We also estimated that CMD's liabilities were overstated by about $192 million as of September 30, 1989. This resulted from liabilities

[2]The Acquisition Management Information System is the primary system CMD uses to support its accounting and financial reporting responsibilities.

[3]Progress payments reimburse contractors for a percentage of their incurred costs on government contracts. Holdbacks are Air Force liabilities which represent the amounts earned by a contractor but not yet paid.

being overstated by $456 million and progress payment holdbacks being understated by $264 million.

We discussed our fiscal year 1988 findings relating to liability reporting with the CMD Comptroller who concurred with the findings and agreed to take corrective actions. Early in fiscal year 1989, CMD began revising the methodology for calculating liabilities. During our fiscal year 1989 review, we examined the new methodology being developed. We found that CMD had made improvements in this area in that liabilities were better defined, even though the amount reported was still not accurate.

Although CMD officials agreed that the reported liabilities were inaccurate, they did not report this problem as a material weakness in their Annual Statement of Assurance on the Status of Internal Controls for Fiscal Year 1989 report. This report is prepared to provide information for DOD's report required by the Federal Managers' Financial Integrity Act (FMFIA). CMD officials told us they would not include liability reporting in their Financial Integrity Act report until we formally reported on the issue. We disagree with CMD officials' view that liability reporting should have been excluded from the 1989 report. CMD was aware of the internal control weakness when it prepared the report, and we see no benefit to any delay in reporting and correcting an acknowledged deficiency.

Procedures for Conducting Inventories of Treasury Checks Were Flawed

CMD uses two types of Treasury checks in making contractor payments. Regular checks are standard Treasury checks used in most cases, whereas control checks, the other type of checks, are used to replace regular checks which are spoiled (that is, written for the wrong amount) during preparation or returned by payees in a mutilated but identifiable form. Air Force Regulation 177-108 requires monthly[4] surprise inventories of both regular and control checks.

During our fiscal year 1989 review of controls over CMD's paying and collecting function, we found that CMD's inventories of both types of checks were inadequate. Initially, CMD was only conducting monthly inventories of regular checks. During our review, however, CMD began including control checks in its inventory process.

CMD's procedures for conducting the inventory for both types of checks were flawed. The procedures included reviewing the check control

[4]These inventories, as of September 15, 1989, are required quarterly.

record but did not include an actual count of the checks on hand for comparison purposes. Rather, CMD subtracted the check number of the checks issued from the previous day's ending balance to obtain the new balance. This procedure allowed mathematical errors to occur, and some of them went unnoticed for several months. For example, four separate calculation errors were made during a 3-month period which showed a shortage of 98 checks. Although the checks actually were not missing, the errors on the Check Control Record went unnoticed for 4 months until CMD actually counted Treasury checks on hand.

CMD internal controls should be adequate to promptly detect any stolen, lost, or misplaced checks. To accomplish this objective, the number of checks on hand must be periodically verified. This is especially critical for CMD, because, according to Air Force Regulation 177-108, checks can be written for any amount up to (but not including) $100 million. If controls are not adequate, millions of dollars could be spent inappropriately without prompt detection by CMD. During the course of our audit, however, CMD agreed to change procedures to include an actual count of checks on hand and comparison with the check control record.

Contracting Officers Do Not Always Report Contractor Debts

Many CMD contract administration responsibilities are carried out by contracting officers at the AFPROs. One such responsibility is to issue demand letters to contractors for repayment of advances, liquidated damages, and certain other debts owed the government. Air Force Regulation 177-102 requires contracting officers to notify CMD of a debt at the same time demand for payment is made of the contractor. For accounting purposes, demand letter amounts should be entered into CMD's books as receivables.

Contracting officers at 7 of the 28 AFPROs we contacted during our fiscal year 1989 audit said that they do not routinely notify CMD of contractor debts. CMD reported over $64 million in refund receivables to AFAFC as of September 30, 1989. However, because some contracting officers do not notify CMD of contractor debt, the amount reported is likely to be understated. We do not believe that the fiscal year 1989 understatement materially affected the Air Force financial statements. CMD officials agreed that all refund receivables were not reported and planned to take corrective action.

Weaknesses Exist in AFPRO Controls Over Government Assets

We reviewed internal controls over progress payments and government property at three AFPROs—General Electric Company, Evendale, Ohio; Hughes Aircraft Company, El Segundo, California; and Rockwell International Corporation, Anaheim, California. To assess controls, we (1) reviewed procedures followed to approve 30 progress payment requests, (2) reviewed surveillance reports on the use of government property, and (3) conducted a physical inventory of judgmentally selected pieces of government property. Our tests showed that internal controls over progress payments and government property need strengthening.

Controls Over Progress Payments Are Not Adequate to Prevent Overpayments

Progress payments are a form of contract financing which may be used when (1) work must generally begin 4 or more months prior to the contractor being able to bill for products delivered and (2) expenditures for contract performance during the predelivery period will have a significant impact on the contractor's working capital. According to the Federal Acquisition Regulation, progress payments should be based on contractor incurred costs that are reasonable, can be allocated to the specific contract, and are consistent with sound accounting principles and practices. To accomplish this, effective internal controls must be in place. AFPROs have primary responsibility for ensuring internal controls are adequate for proper progress payments.

We found that the AFPROs followed required procedures for approving progress payments. However, we identified two weaknesses—the return of approved progress payment requests to contractors by the three AFPROs and failure of the AFPRO at General Electric to determine the cause for persistent differences between the number of engine assemblies it verified and the number disclosed by contractor records supporting progress payment requests.

Return of Approved Progress Payment Requests to Contractors

Contractors normally request progress payments each month. The AFPROs are responsible for evaluating the information on the progress payment requests and determining the validity of the amounts requested. The AFPROs are also responsible for periodically assessing the contractors' physical progress to ensure that it is commensurate with the incurred costs reported on the progress payment requests.

After determining a progress payment request is valid, an AFPRO administrative contracting officer signs the request form, enters the approved amount on the appropriate line on the request form, and returns the approved form to the contractor. The contractor, in turn, forwards it to CMD who makes the payment.

During fiscal year 1989, CMD made over $14 billion in progress payments which included over $4 billion in progress payments from research, development, test, and evaluation funds. This amount includes progress payments made on contracts administered by the three AFPROs we visited.

The AFPROs' practice of returning approved progress payment requests to contractors for submission to CMD weakened controls by giving contractors a chance to alter approved payment amounts. The Comptroller of the Air Force, in a July 19, 1988, memorandum on payments to contractors stated that internal controls had at times been weakened by this practice.

We could not determine why approved progress payment requests were returned to contractors. However, according to an Air Force Audit Agency report entitled Payments to Contractors, June 19, 1989, approved requests are returned to the contractors to expedite the payment process. It is DOD's goal to make progress payments within 7 days unless factors such as geographical separation and workload warrant a greater period.

We found no indications of altered progress payment requests. Nor did the Air Force Audit Agency find any during its earlier review. The Air Force Audit Agency concluded that controls over this aspect of progress payments were adequate because (1) the progress payment form incorporated analyses designed to limit payments to the contractually authorized amounts, (2) the Acquisition Management Information System checks the total of previous progress payment requests and other information against information in its data base when approved payments are processed, and (3) the administrative contracting officers have access to the Acquisition Management Information System payment data base through on-site terminals. Although we agree that, with these procedures, alterations should subsequently be detected, it is our view that the AFPROs should be required to forward the approved requests to CMD. This change would entail negligible costs to the government while significantly improving internal controls. Additional time required to forward the approved requests to CMD should also be minimal.

AFPRO for General Electric Did Not Resolve Discrepancies

Our tests showed that the AFPRO for General Electric did not adequately follow up on discrepancies identified between units claimed by the contractor and those verified by the AFPRO through the progress payment approval process. It is especially important that controls be effective at this location to prevent misallocations of costs between U.S. military, foreign military, and commercial contracts. The contractor uses the same production line for both commercial and government engines and assigns the combined costs to individual contracts based on its master manufacturing schedules which document the projected number of engines to be manufactured for customers.

The number of engines and engine assemblies on hand should approximate the total number indicated by the manufacturing schedules unless the contractor is either ahead or behind production. If the contractor is ahead of schedule or producing more engines than required by the manufacturing schedule, the number of engines and assemblies on hand should be greater than the number indicated by the build schedules. The reverse is true when the contractor is behind schedule. This relationship enables the AFPRO to use physical counts of the units on hand as a control technique to ensure an accurate apportionment of costs. The AFPRO conducts the physical counts at least annually and compares the results to the number reported by the contractor on supporting progress payment documentation.

We reviewed the results of four AFPRO physical counts conducted between October 1988 and October 1989. For all four, the AFPRO verified significantly fewer units than claimed by the contractor.

Table 4.1: Comparision of Units as Reported by Contractor and Verified by the AFPRO

Date of AFPRO count	Number of units contractor reported	Number of units AFPRO verified	Difference
October 1988	115	41	74
November 1988	80	37	43
December 1988	68	33	35
October 1989	53	32	21

As shown, significant shortages existed between units claimed by the contractor and verified by the AFPRO. The AFPRO, however, took only limited action to determine whether costs assigned to the individual contracts were proper. Actions taken by the AFPRO to resolve the discrepancies identified in 1988 were limited to discussing the differences with the contractor. According to an AFPRO official, these discussions resulted in the contractor reducing the number of units claimed in subsequent requests for progress payments.

Following the October 1989 physical count, however, the AFPRO revised its methodology for counting physical units to consider units in the earlier stages of the production process. This had not previously been done. While we agree consideration should be given to units in all stages of production, we also believe that the AFPRO should have a verifiable basis to determine the number of units in each stage of production. The AFPRO, however, attributed the difference between the units it counted and what the contractor reported to units in the earlier stage of production, without verifying the existence of the additional units.

Actions taken by the AFPRO to date, have not, in our opinion, ensured that incurred costs are being allocated properly and that progress payments are made only for existing assets. As a result, we do not believe the AFPRO knows (1) the reason(s) for the discrepancies, (2) the impact of the discrepancies, if any, on incurred costs, and (3) whether the basis for allocating costs to individual contracts is valid. Without these determinations, the AFPRO does not have adequate assurance that progress payment requests are reasonable and based only on properly allocable incurred costs.

Controls Over Government Property Are Ineffective

As one means of accomplishing its mission, the Air Force contracts with private companies to produce, maintain, and repair weapon systems and to provide various services in support of those systems and the Air Force. Although contractors are ordinarily required to acquire the property, materials, and equipment necessary to perform government contracts, in some cases, the Air Force furnishes the real property, plant equipment, special tooling, and other materials necessary. These items are commonly referred to as government-furnished property. In addition, contractor property records are the basis for amounts reported in Air Force financial reports valuing government property in contractor possession.

Contractors are responsible for safeguarding and controlling the use of government property in their possession. According to the FAR, contractors are also responsible for maintaining the government's official records on this property. These records are the basis for amounts reported in Air Force financial reports on the value of government property in contractor possession.

AFSC has certain responsibilities related to government property in contractors' possession. Specifically, the AFPROs are responsible for ensuring that

- property is used only when authorized,
- rent is charged for use in nongovernment programs,
- contractors include basic information required by the FAR in official property records, and
- contractors justify retaining the property when not in use.

Property Records Are Not Accurate

One objective of a system of internal controls is to help provide management with reasonable, but not absolute, assurance that funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation. At three AFPRO locations, we noted inaccurate records and poor controls over property. Our review of contractor records and a physical inspection of property items disclosed numerous deficiencies: (1) property was not in the location cited, (2) property was no longer in the contractors' possession, (3) records showing ownership were unclear or inaccurate, and (4) recorded item values were missing or inaccurate. Thus, the contractors were reporting inaccurate information on the amount and value of government property in their possession. These weaknesses could result in the loss or unauthorized use of government property.

AFPROs at the three locations we reviewed had previously identified deficiencies similar to those we found. The AFPRO approves the contractor's property management system and performs annual surveys to ensure the approved system is working as intended. We reviewed the AFPRO's procedures for monitoring contractor property management, as well as results of their annual surveys, at all three locations. At one location, the AFPRO identified deficiencies significant enough for it to consider withdrawing approval of the property control system. At the other two locations, the AFPROs cited the contractors' property management as deficient for several reasons, including (1) property could not be located, (2) inaccurate property records on the location of property, (3) missing and inaccurate unit prices in the official property records, and (4) other internal control weaknesses.

Although the contractors submitted acceptable plans for correcting the specific deficiencies identified by the AFPROs, our review of records and physical inventory of selected items still disclosed recordkeeping weaknesses. For example, none of the contractors had updated property records to indicate the current location of all government property. As a result, some records still listed property no longer in the custody of the contractor.

Another contractor, whose records did not properly reflect government ownership of a piece of material, loaned that material to a vendor without the AFPRO's prior knowledge. The contractor classified the loan as a consignment, which normally would have entitled the vendor to sell the material. However, the vendor later returned that material, which had a unit cost of $52,000.

Finally, we found deficiencies concerning the value of government property reported by contractors. At one location, records for 353 items, including a jet engine, did not contain unit prices. We also found obviously incorrect unit prices for several other items. Although the FAR allows unit prices to be estimated, we found pieces of property listed with $1 unit prices even though the same or similar pieces of property were listed with significantly higher unit prices. For example, one adapter set was reported to have a $1 unit price while another set had a reported unit price of $15,000 even though the parts were the same.

According to the FAR, contractor records are the official government records of property in contractors' possession. The FAR, in most cases, does not allow duplicate official records to be maintained by government personnel. Therefore, it is essential that contractor records be current, accurate, and complete and that periodically the AFPRO verify their reliability. Otherwise, the financial reports on government property will continue to be inaccurate. In some cases, this could lead to the loss or misuse of government property as evidenced by the deficiencies the AFPRO and we identified.

Sale of Industrial Plant Equipment Raises Questions About Air Force and DOD Policies

While reviewing controls over government property at General Electric's Evendale plant, we found that a large amount of industrial plant equipment (IPE) was sold to the contractor during fiscal year 1989. The FAR Supplement defines IPE as government-furnished equipment provided to contractors for the purpose of cutting, grinding, shaping, forming, or otherwise altering the physical, electrical, or chemical makeup of materials, components, or end items. By FAR definition, IPE excludes items with a unit cost of less than $5,000. The Defense Logistics Agency's Defense Industrial Plant Equipment Center (DIPEC) manages idle IPE. In this regard, DIPEC coordinates the movement of equipment from a contractor who is not currently using it to another DOD contractor who needs it.

Defense Logistics Agency Manual 4215.1 establishes systems and procedures for the control and redistribution of idle IPE within DOD. This regulation requires DOD organizations to promptly notify DIPEC when IPE becomes idle. However, Air Force Regulation 78-22 allows IPE to be sold in conjunction with the sale of Air Force industrial plants when ownership of the plants is no longer necessary. It is not clear whether the latter includes idle equipment.

The Air Force, through the General Services Administration, sold its Evendale industrial plant to General Electric. The General Services Administration sold the plant for $18.1 million on June 30, 1989. The sale included 66 acres of land, 1.2 million square feet of building space, a fuel storage area, 513 pieces of IPE, and other personal property. The acquisition cost of the land, plant, and equipment sold to General Electric was about $67 million, and its appraised value was $37.4 million.

Several aspects of this sale concern us. First, although the IPE was not declared idle, AFPRO officials told us General Electric may have auctioned some of the IPE it purchased. This raises the question of whether some items were idle prior to the sale and DIPEC should have been given an opportunity to redistribute them. Second, when DIPEC was informed of the sale, about a month after consummation, the latter identified some items sold to the contractor that were needed by other DOD agencies. DIPEC correspondence indicates that DOD needed 156 pieces of the IPE sold by the Air Force. Third, again according to DIPEC correspondence, the replacement cost for the 156 items it would have retained was about $22 million. If DIPEC is correct, the cost to DOD of replacing 156 pieces of the IPE is greater than the Air Force received for the sale of plant. Overall, this situation raises questions regarding Air Force policies and procedures for selling IPE, especially given DOD's redistribution policies. We plan to investigate these issues, and, if appropriate, report on them later.

Conclusions

The Contract Management Division administered about 29,000 contracts and paid over $20 billion to contractors for both fiscal years 1988 and 1989. In its capacity as the principal Air Force contract administrator, it is imperative that CMD has strong internal controls necessary to ensure accurate payments to contractors, proper financial reporting, and proper accounting and control over the use of government assets.

We found that controls over some areas need strengthening. For example, we found that CMD's procedures for inventorying Treasury checks were flawed in that the checks were not actually counted. Continued use of this procedure could have resulted in failure to detect lost, stolen, or misplaced checks. Further, some contracting officers were not notifying CMD of contractor debts as required by Air Force regulations. Consequently, the amount of refunds receivables reported by CMD were likely understated which resulted in further inaccuracies in AFSC financial reports.

We also found that AFPRO controls over progress payments and government property need strengthening. For example, the AFPROs returned approved progress payment requests to the contractor for submission to paying offices, a practice we believe weakens controls and could result in improper payments. Also, we found that the AFPRO for General Electric did not adequately follow up on discrepancies in the number of units claimed by the contractor and verified by the AFPRO. Finally, we found additional emphasis and monitoring is needed to resolve numerous recordkeeping and property management deficiencies. These deficiencies included property the contractor could not locate, property in the contractor's inventory listing but no longer in the contractor's possession, property with missing and inaccurate pricing, and property where government ownership was not clear.

Recommendations

The Contract Management Division is now a component of the Defense Logistics Agency. Therefore, we recommend that the Director of the Defense Logistics Agency

- ensure that the Contract Management Division's efforts to correct liability reporting problems are promptly completed and that its new report and liability data base are validated;
- direct the Contract Management Division to disclose its liability reporting problems, if uncorrected, as a material weakness in its Annual Statement of Assurance on the Status of Internal Controls for fiscal year 1990;
- direct the Contract Management Division to continue counting Treasury checks on hand when performing monthly inventories;

- direct contracting officers administering Contract Management Division contracts to comply with Air Force Regulation 177-102 by notifying CMD when a demand for payment is made of a contractor;
- make each AFPRO responsible for forwarding approved progress payment requests to the paying office;
- require AFPROs to perform the follow-up necessary to ensure that progress payment requests are accurate and appropriately relate to incurred cost and physical progress; and
- direct AFPROs to monitor more comprehensively and more frequently contractor systems and compliance procedures for recording and reporting of government owned property.

Abnormal General Ledger Account Balances Reported by AFSC Organizations for Fiscal Years 1988 and 1989

Account and organization	Amount reported for fiscal year 1988	Amount reported for fiscal year 1989
Accounts payable		
AFFTC		$12,572,255
Accounts receivable reimbursable		
HSD		1,453,620
ESMC	$5,989,426	1,784,435
ESD		21,181,641
Accounts receivable—other		
ESMC	18,209,111	20,000,944
Accounts receivable, U.S. Treasury (Statistical)		
ESD		8,180,501
Accrued payroll		
AFFTC		73,933
Advance payments		
AFFTC	127,475	
Construction in progress		
AFFTC	3,567,596	11,104,690
ESD	773,000	773,000
Deposit fund liability		
SSD	2,063,710	
AEDC	63,672	
Disbursements—transfers out		
ASD		14,409,245
General expense		
ESD		644,700,115
Material—transfers out		
SSD		23,293,749

Account and organization	Amount reported for fiscal year 1988	Amount reported for fiscal year 1989
Sale of services		
AFFTC	76,964,082	
Unearned revenue		
MSD	1,032,146	596,719
ESD		33,401,842
Total	**$108,790,218**	**$793,526,689**

Fiscal Year 1989 Adjustments Required to AFSC's Consolidated Trial Balance

Activity	Account	Total[a] amount	Net[b] effect
AFFTC	Accounts payable	$27,287,539	$27,287,539
AFFTC	Accrued annual leave	16,511,370	5,754,053
AFFTC	Accrued payroll	2,617,496	2,617,496
AFFTC	Cost of reimbursable services	69,901,638	69,659,550
ASD	Accounts receivable	2,877,156	1,490,636
ASD	Accounts receivable other	34,585,206	506,534
ASD	Accrued annual leave	3,247,353	3,200,773
ASD	Advance payments	4,632,712	4,037,314
ASD	Equipment in use	17,443,367	1,357,883
ASD	General expense	13,725,159,200	13,725,159,200
ASD	Net investment	11,195,647	11,195,647
ASD	Real property host	149,382,112	149,382,112
ASD	Sale of services	150,098,140	46,367,348
ASD	Work in process (progress payments)	1,675,375,866	7,544,643
CMD	Accounts payable	191,716,872	191,716,872
ESD	Accounts receivable, U.S. Treasury (statistical)	8,180,501	8,180,501
ESD	Construction in progress	773,000	773,000
ESD	Equipment in use	79,573,775	79,573,775
ESD	General expense	2,207,435,338	2,207,435,338
ESD	Real property—transfers in	12,566,230	12,566,230
ESD	Real property—transfers out	143,000	143,000
ESMC	Accounts receivable, other	37,101,229	37,101,229
HSD	Unearned revenue	3,133,502	3,133,502
MSD	Operating expenses—transfers in	280,276,738	280,276,738
MSD	Unearned revenue	1,128,316	1,128,316
MSD	Work in process (progress payments)	358,788,472	358,788,472
SSD	Construction in progress	25,669,898	25,669,898
SSD	Equipment in use	3,591,805	3,591,805
SSD	Material in stores	562,744	562,744
SSD	Material—transfers out	59,498,220	59,498,220
Total		**$19,160,454,442**	**$17,325,700,368**

[a]Includes reversing and correcting entries required to correct errors in account balances.

[b]Reflects the difference between the originally reported account balances and the revised balances after correction of errors.

Required Fiscal Year 1988 and 1989 Adjustments by Account

Account	Fiscal year 1988	Fiscal year 1989
Accounts payable	$400,000,000	$219,004,411
Accounts receivable	69,942,876	2,877,156
Accounts receivable, other	257,177	71,686,435
Accounts receivable, U.S. Treasury (statistical)	1,811,382	8,180,501
Accrued annual leave	4,582,505	19,758,723
Accrued payroll		2,617,496
Advanced payments		4,632,712
Construction in progress		26,442,898
Cost of reimbursable services		69,901,638
Disbursements—transfers out	68,000,000	
Equipment in use		100,608,947
General expense	499,863,307	15,932,594,538
Material in stores		562,744
Materials—transfers out		59,498,220
Net investments		11,195,647
Operating expenses—transfers in		280,276,738
Real property, host		149,382,112
Real property—transfers in		12,566,230
Real property—transfers out		143,000
Sale of services		150,098,140
Statistical accounts, contra	8,303,644	
Unearned revenue		4,261,818
Work in process (progress payments)		2,034,164,338
Total	**$1,052,760,891**	**$19,160,454,442**