Audit Report

OFFICE OF THE INSPECTOR GENERAL

CAPITALIZATION OF DEFENSE TECHNOLOGY SECURITY ADMINISTRATION EQUIPMENT

Report No. 97-020 November 4, 1996

Department of Defense

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Acronyms

DFAS	Defense Finance and Accounting Service
DTSA	Defense Technology Security Administration
WAAS	Washington Headquarters Services Allotment Accounting System

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

November 4, 1996

MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE TECHNOLOGY SECURITY ADMINISTRATION
DIRECTOR, WASHINGTON HEADQUARTERS SERVICES

SUBJECT: Audit Report on the Capitalization of Defense Technology Security Administration Equipment (Report No. 97-020)

We are providing this audit report for information and use. We considered comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Mary Lu Ugone, Audit Program Director, at (703) 604-9529 (DSN 664-9529). See Appendix F for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 97-020 **November 4, 1996**
(Project No. 5RF-6010.14)

The Capitalization of Defense Technology Security Administration Equipment

Executive Summary

Introduction. The Defense Technology Security Administration serves as the focal point within DoD for administering the DoD Technical Security Program and develops and implements DoD policies on international transfers of defense-related goods, services, and technologies. For FY 1995, the Defense Technology Security Administration reported $5.2 million in the Equipment in Use account on its trial balance. Starting with FY 1996, Defense Technology Security Administration financial data will be included in consolidated DoD financial statements. The Defense Finance and Accounting Service-Pentagon provided accounting support for the Defense Technology Security Administration until April 1996. At that time, the Defense Finance and Accounting Service-Denver transferred the accounting support work load to the Defense Finance and Accounting Service-Indianapolis.

Audit Objectives. The overall audit objective was to determine the accuracy of the Defense Technology Security Administration FY 1995 Equipment in Use general ledger account balance. Specifically, we tested accounting transactions to validate the capitalization[1] criteria the Defense Technology Security Administration used in capitalizing equipment and to verify that assets listed in the Equipment in Use account were in use as of September 30, 1995. Also, we evaluated the management control procedures the Defense Technology Security Administration established for recording equipment transactions.

Audit Results. The FY 1995 general ledger Equipment in Use account was overstated for the Defense Technology Security Administration. Specifically, the account included $1.4 million for equipment that should have been expensed and $0.2 million for equipment that was no longer in use. As a result, the Equipment in Use account, reported as $5.2 million on the Defense Technology Security Administration FY 1995 trial balance, was significantly misreported.

The management control program for the Defense Technology Security Administration and Defense Finance and Accounting Service-Indianapolis could be improved by establishing controls to ensure that disposed of equipment is removed from the appropriate accounts. Additionally, the Defense Finance and Accounting Service-Indianapolis management control program could be improved by establishing controls to ensure that equipment procurements are adequately analyzed to determine whether procured equipment should be capitalized or expensed. Recommendations in the report, if implemented, will result in a more accurate Defense Technology Security Administration Equipment in Use general ledger balance and improved financial reporting.

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[1]Property purchased is "capitalized" when it is recorded as an asset in financial accounting records. The cost of property not capitalized is recorded as a current operating expense.

Summary of Recommendations. We recommend that Washington Headquarters Services reestablish controls in the Washington Headquarters Services Allotment Accounting System to distinguish between capital[2] and noncapital[3] equipment acquisitions, and issue appropriate guidance to the organizations that provide accounting support using the Washington Headquarters Services Allotment Accounting System. We recommend that the Defense Finance and Accounting Service-Indianapolis make the appropriate data entry in the Washington Headquarters Services Allotment Accounting System upon determining whether equipment acquisitions are for capital or noncapital equipment and establish standard operating procedures on information required from Defense agencies to properly record disposed of equipment. We also recommend that the Defense Technology Security Administration establish accounting controls to ensure that the Equipment in Use account accurately reflects the acquisition cost of equipment in use.

Management Comments. The Washington Headquarters Services concurred with the recommendations, agreed to make the necessary data entries, and has initiated corrective actions. The Defense Finance and Accounting Service proposed alternative actions, which when combined with actions taken by the Washington Headquarters Services, are responsive to the recommendation on making the appropriate data entry for equipment acquisitions. Additionally, the Defense Finance and Accounting Service agreed to provide standard operating procedures for Defense agencies to report correct equipment balances on financial statements. The Defense Technology Security Administration concurred with the recommendations and has initiated corrective actions.

See Part I for a discussion of management comments and Part III for the complete texts of the comments.

Audit Response. The comments and actions taken by the Defense Finance and Accounting Service, the Defense Technology Security Administration, and the Washington Headquarters Services are responsive to our recommendations. No additional comments are required.

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[2]Capital equipment acquisitions are acquisitions that meet the current year capitalization threshold and, therefore, are charged to an asset equipment account.

[3]Noncapital equipment acquisitions are acquisitions that do not meet the current year capitalization threshold and, therefore, are charged as an operating or program expense.

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Part I - Audit Results

Audit Background

The Secretary of Defense established the Defense Technology Security Administration (DTSA) on May 10, 1985, as a DoD field organization under the direction, authority, and control of the Under Secretary of Defense for Policy. The Secretary of Defense created the DTSA to consolidate the various export control and related technology security functions of the DoD by bringing together a number of positions from the Offices of the Under Secretary of Defense for Policy and the Under Secretary of Defense for Acquisition and Technology. The Deputy Under Secretary of Defense for Trade Security Policy also serves as the Director of DTSA, with responsibility for overall supervision of DTSA. Washington Headquarters Services provides administrative support for DTSA.

DTSA serves as the focal point within DoD for administering the DoD Technology Security Program. Specifically, DTSA develops and implements DoD policies on international transfers of defense-related goods, services, and technologies to ensure that:

o critical U.S. military technological advantages are preserved,

o transfers of defense-related technology that could be detrimental to U.S. security interests are controlled and limited,

o proliferation of weapons of mass destruction and their means of delivery is prevented, and

o legitimate defense cooperation with foreign allies and friendly nations is supported.

Public Law 101-576, The Chief Financial Officers Act of 1990, and Public Law 103-356, the Federal Financial Management Act of 1994, require DoD to prepare annual consolidated financial statements starting with FY 1996. The consolidated DoD financial statements for FY 1996 will include DTSA financial data.

For its FY 1995 trial balance, DTSA reported $5.2 million in the Equipment in Use account. The Equipment in Use account represents 37 percent of total DTSA net assets. DTSA will use the trial balance to report financial information for the consolidated DoD financial statements.

The Defense Finance and Accounting Service (DFAS)-Pentagon provided accounting support for DTSA until April 1996. In April 1996, DFAS-Denver transferred the accounting support work load to DFAS-Indianapolis. Both DFAS-Pentagon and DFAS-Indianapolis use the Washington Headquarters Services Allotment Accounting System (WAAS) to process and report accounting transactions.

Audit Objectives

This audit supports the Inspector General, DoD, audit of the FY 1996 DoD-wide financial statements. The audit objective was to determine the accuracy of the DTSA FY 1995 general ledger Equipment in Use account balance. Specifically, we tested accounting transactions to validate the capitalization[1] criteria DTSA used in determining capital[2] equipment and to verify that assets listed as Equipment in Use were in use as of September 30, 1995. Also, we evaluated DTSA management control procedures for recording equipment transactions. See Appendix A for a discussion of the audit scope and methodology and the review of the management control program and for a summary of prior coverage related to the audit objectives.

See Appendix B, Other Matters of Interest, for a discussion of expired funds shown as direct funding available on the DTSA fund certification report and for a discussion on how our prior recommendation to apply one capitalization threshold to all DoD assets will affect DTSA records.

[1]Property purchased is "capitalized" when it is recorded as an asset in financial accounting records. The cost of property not capitalized is recorded as a current operating expense.

[2]Capital equipment acquisitions are acquisitions that meet the current year capitalization threshold and, therefore, are charged to an asset equipment account.

Capitalization of Equipment at the Defense Technology Security Administration

The DTSA general ledger Equipment in Use account was overstated for FY 1995. Specifically, the DTSA Equipment in Use account included:

o $1.4 million for equipment that should have been expensed, and

o $0.2 million for equipment that was no longer in use.

The account was overstated because the WAAS does not distinguish capital equipment acquisitions from noncapital equipment acquisitions[3] on a unit cost basis. Additionally, DFAS-Indianapolis did not remove the value of disposed of equipment from the appropriate general ledger accounts.

As a result, the DTSA FY 1995 Equipment in Use account, reported as $5.2 million on the DTSA FY 1995 trial balance, was significantly misreported.

The Washington Headquarters Services Allotment Accounting System

The WAAS is a General Accounting Office approved installation-level accounting system. The WAAS provides general ledger control over appropriated funds and accounts for both expenditure and reimbursable line item accounting.

The WAAS does not distinguish capital and noncapital equipment acquisitions within the equipment object code. When the total cost of an equipment acquisition exceeds the capitalization threshold and the user designates the acquisition as object code "31," the WAAS automatically capitalizes the procurement.

Definition of Object Code. Object codes are used as a uniform classification for identifying the transactions of the Federal Government by the nature of the goods or services purchased. Every obligation recorded by the DoD must have

[3]Noncapital equipment acquisitions are acquisitions that do not meet the current year capitalization threshold, and, therefore, are charged as an operating or program expense.

an object code. The Under Secretary of Defense (Comptroller) assigns the first two digits of the object code. DoD Components assign the third and fourth digits. DoD has classified object code 31 as Equipment.

Determination of Capitalization Cost. As of June 1996, the WAAS capitalizes equipment transactions based on total procurement cost rather than the unit cost. Transaction number 7, as described in Appendix C, is an example of a purchase that was incorrectly capitalized because the unit cost is well below the capitalization threshold, but the total cost exceeds the capitalization threshold.

The WAAS System Manager is able to reestablish the WAAS capability to account for capital and noncapital equipment transactions by line item within object code 31. DoD 7000.14-R, "Financial Management Regulation," volume 1, "General Financial Management Information, Systems, and Requirements," May 1993, states that object code 31, Equipment, may consist of equipment that is capital equipment and equipment that is noncapital equipment. The WAAS has the capability to identify capital and noncapital equipment transactions within the equipment object code. However, the Washington Headquarters Services has not implemented a feature to identify capital or noncapital equipment as of June 1996 because of the large amount of capital equipment that resulted from the low capitalization thresholds used before FY 1995.

DoD Capitalization Criteria

General ledger account 1762, Equipment in Use, reflects the acquisition cost of equipment that meets the DoD capitalization criteria. DoD capitalization criteria requires that:

o equipment have an estimated life of 2 years or more and

o the acquisition cost must be greater than the established expense and investment thresholds.

Acquisition Cost of DoD Procurements. The Financial Management Regulation, volume 4, "Accounting Policy and Procedures," January 1995, states that the acquisition cost consists of the amount paid for the property and the costs of transportation, installation, and other related costs of obtaining equipment and preparing the equipment for use. In the case of computer systems, the acquisition cost is based on the cost of a complete system rather than on the unit costs of a system's individual components.

Capitalization Thresholds. The DoD capitalization threshold is identical to and automatically changes with the expense and investment thresholds established by Congress. Table 1 shows the fiscal years and various capitalization thresholds.

Table 1. Capitalization Thresholds for Equipment

Fiscal Year	Threshold
Before 1985	$ 1,000
1985	5,000
1992	15,000
1994	25,000
1995	50,000
1996	100,000

DTSA Equipment in Use Account

DoD Components use account 1762, Equipment in Use, to record the acquisition cost of equipment placed in use. DTSA assigns applicable object codes to equipment acquisitions; those codes were intended and are used for budgetary, not proprietary accounting purposes. As of June 1996, the assignment of object code classifications by DTSA did not provide enough information for WAAS to correctly capitalize equipment procurements. When the WAAS automatically capitalized procurements, as discussed earlier in the report, the capitalization was often incorrect because it was based on total acquisition cost rather than on unit cost, system cost, or total acquisition cost, as applicable.

We reviewed a judgment sample of 11 transactions (see Table 2). All 11 were assigned object code "3124," which is automated data processing and word processing equipment. Nine of the eleven acquisitions were wholly or in part incorrectly capitalized. The reasons for the incorrect capitalization included:

o equipment with a unit cost below the capitalization threshold (Transaction Numbers 4, 7, 8, 9, 10, and 11);

o software with a useful life of less than 2 years (Transaction Number 2); and

o contract services that did not meet the definition of acquisition cost (Transaction Numbers 1 and 5).

Appendix C discusses the transactions in more detail.

Table 2. Sample Equipment in Use Transactions

Transaction Number	Document Number*	Trial Balance Amount	Correctly Capitalized	Incorrectly Capitalized
1	AM10006	$ 183,804	$117,938	$ 65,866
2	AM10008	326,000		326,000
3	AM10010	481,890	481,890	
4	AM10012	179,296		179,296
5	AM10013	885,071	353,698	531,373
6	AM10014	20,765	20,765	
7	AM10015	49,387		49,387
8	AM10017	129,039		129,039
9	AM10018	25,399		25,399
10	AM10019	20,000		20,000
11	AM00012	69,806		69,806
Total		**$2,370,457**	**$974,291**	**$1,396,166**

*For all the sample transactions, DTSA used military interdepartmental purchase requests to transmit funding authority to contracting offices. DTSA does use other funding documents to purchase equipment.

According to the Financial Management Regulation, volume 4, "Accounting Policy and Procedure," January 1995, the capitalization threshold for capitalizing computer equipment should be applied based on the total system cost for computer systems, on unit costs for stand-alone computers, and on unit costs for additions to computer systems, unless the addition qualifies as a computer system separate from the system to which it is being added. If the addition qualifies as a computer system, then the capitalization threshold should be applied based on the total system cost.

The transactions that comprise the DTSA FY 1995 general ledger Equipment in Use account balance occurred in FYs 1988 through 1991. Since nothing had been capitalized in the account since FY 1991, we reviewed FYs 1994 and 1995 Military Interdepartmental Purchase Requests to determine whether any transactions in the Equipment in Use account should have been capitalized. We reviewed 34 transactions, totaling $3.1 million, and confirmed that none of the 34 purchases should have been capitalized. Appendix D lists the DTSA FYs 1994 and 1995 Military Interdepartmental Purchase Requests we reviewed.

Equipment No Longer in Use

Two transactions for equipment, totaling $187,744, had been disposed of before September 30, 1995, and were incorrectly included in the asset account. The

Financial Management Regulation, volume 4, states that once equipment has been disposed of, the acquisition cost should be removed from the applicable accounts. Table 3 lists the transactions for the disposed of equipment, and Appendix C describes the transactions in more detail.

Table 3. Transactions for Disposed of Equipment

Transaction Number	Document Number	Disposed of Amount
1	AM10006	$117,938
11	AM00012	69,806
Total		**$187,744**

DTSA and DFAS-Indianapolis personnel indicated that DFAS-Indianapolis had not established standard operating procedures for DTSA to notify DFAS-Indianapolis that equipment has been disposed of and for DFAS-Indianapolis to properly record the disposal of equipment in the financial records. DFAS-Indianapolis needs to establish standard operating procedures that implement accounting policy in Financial Management Regulation, volume 4, so that organizations supported by DFAS properly record disposed of equipment.

Effects on DTSA General Ledger Account Balances

The inaccuracy of the FY 1995 Equipment in Use account consisted of:

- o $1.4 million for equipment that should have been expensed and
- o $0.2 million for equipment that has been disposed of.

The DTSA should have charged $1.4 million to one of the operating and program expense accounts in the 6100 series of accounts:

- o account 6121, Supplies and Materials,
- o account 6122, Equipment-Not Capitalized, or
- o account 6120, Other Services.

Because expense accounts are recorded and closed the year transactions occur, the summary account 6100, Operating and Program Expenses, was understated in the DTSA general ledger.

Further, at the end of each fiscal year, expense accounts are subtracted from equity account 3000, Equity, which reduces the equity account by the amount of the annual expenses. As a result, the FY 1995 DTSA equity account 3000, Equity was overstated in the DTSA general ledger.

DFAS should have removed the $0.2 million from the Equipment in Use asset account and the Equity account in accordance with the requirements in the Financial Management Regulation, volume 4. Because the costs were not removed, both the Equipment in Use and Equity accounts are overstated by the value of the equipment that had been disposed of.

Conclusion

The Washington Headquarters Services needs to reestablish controls in the WAAS to identify capital and noncapital equipment acquisitions by line item. Once those controls are reestablished, the Washington Headquarters Services needs to announce this feature to the users of the WAAS. This action must be taken so that all organizations supported by the WAAS are able to correctly capitalize equipment procurements. The reestablishment of controls in the WAAS for recording capital and noncapital equipment procurements will result in accurate Equipment in Use accounts for all organizations supported by the WAAS, provided those organizations establish accounting controls to ensure that the acquisition cost of capital equipment placed in use is accurately reflected in the Equipment in Use account.

Additionally, DFAS-Indianapolis needs to analyze each equipment acquisition by line item identified by object code 31 to determine whether the acquisition was for capital or noncapital equipment and to make the appropriate data entry in the WAAS.

Recommendations, Management Comments, and Audit Responses

1. We recommend that the Director, Washington Headquarters Services:

a. Reestablish controls in the Washington Headquarters Services Allotment Accounting System to distinguish capital equipment acquisitions from noncapital equipment acquisitions.

b. Revise the Washington Headquarters Services Allotment Accounting System operating procedures to state that it has been updated and can accept capital and noncapital equipment acquisitions within object

code 31, and issue the revised procedures to the organizations that provide accounting support using the Washington Headquarters Services Allotment Accounting System.

Management Comments. The Washington Headquarters Services concurred. The Washington Headquarters Services added a new data element to the transaction level of the WAAS to identify capital and noncapital acquisitions in object code 31. The Washington Headquarters Services also sent a memorandum to all WAAS users providing policy and guidance on the use of the new data element and the resultant general ledger posting. Further, the Washington Headquarters Services provided to each WAAS user a list of all past transactions that procured capital acquisitions for their organizations and requested that the organizations review the list and make needed corrections.

Audit Response. The Washington Headquarters Services comments are responsive. We commend the Washington Headquarters Services for its responsive actions to reestablish controls in the WAAS that distinguish capital equipment acquisitions from noncapital equipment acquisitions and to issue the revised procedures to the organizations using the WAAS.

2. We recommend that the Director, Defense Finance and Accounting Service-Indianapolis:

a. Make the appropriate data entries in the Washington Headquarters Services Allotment Accounting System upon determining whether equipment acquisitions are for capital or noncapital equipment.

b. Establish standard operating procedures for information required from Defense agencies so that Defense Finance and Accounting Service-Indianapolis may properly record disposed of equipment.

Management Comments. The DFAS nonconcurred with Recommendation 2.a. because only the WAAS Administrator has the capability to make adjustment data entries. The DFAS also stated that property book officers have the required data in their subsidiary records to assign property status, but that the WAAS does not have the capability to make adjustments on equipment line items that are being modified, loaned, or salvaged. The DFAS has requested that it be given access capability and that WAAS be modified so that a distinction can be made between capital and noncapital equipment.

The DFAS concurred with Recommendation 2.b., stating that Defense agencies need standard operating procedures and need to be cognizant of the importance of accurate property reporting for financial statements purposes. The DFAS stated that Defense agencies must operate under the same reporting guidelines as other customers serviced by the DFAS. The necessary operating guidance exists. The DFAS will determine whether the system administrator or the system user level is required to input into the WAAS the values of military equipment as reported by property book officers. The estimated completion date of this action is November 1996.

Audit Response. Although the DFAS nonconcurred, its comments are responsive to Recommendation 2.a. The recommendation applies to future transactions not past transactions. The Washington Headquarters Services agreed to make correcting entries to the WAAS for past DTSA transactions and will provide WAAS users an interactive update program during FY 1997, with procedures in place by December 31, 1996. The actions taken by the DFAS in response to Recommendation 2.b. are responsive. Additional comments are not required.

3. We recommend that the Director, Defense Technology Security Administration, establish appropriate accounting controls to ensure that the Equipment in Use account accurately reflects the acquisition cost of equipment placed in use.

Management Comments. The DTSA concurred and is reviewing all purchasing documents to ensure that they comply with legislated acquisition threshold levels, that supporting documentation is readily available and properly maintained, and that data are sent to the DFAS to update the DTSA Equipment in Use account. Additionally, the DTSA changed receiving procedures to link receiving reports to purchase documents and revised its procedures for excess/turn-in equipment.

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Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology. To determine the accuracy of the DTSA FY 1995 Equipment in Use account balance, we reviewed Equipment in Use account procurement transactions to determine whether procured assets should have been capitalized or expensed. We reviewed the DoD accounting policy in DoD Financial Management Regulation, volume 1, "General Financial Management Information, Systems, and Requirements," May 1993, and volume 4, "Accounting Policy and Procedures," January 1995, pertaining to the capitalization of fixed assets in the financial records of general fund organizations.

Use of Computer-Processed Data. To meet the audit objectives, we extensively relied on computer-processed data in the Washington Headquarters Services Allotment Accounting System. We did not find errors that would preclude the use of the computer-processed data to meet the audit objectives or that would change the conclusions of the report.

Audit Period, Standards, and Locations. We performed this financial-related audit from May through June 1996, in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included tests of management controls considered necessary. Appendix E lists the organizations we visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Management Control Program. We reviewed the adequacy of the DTSA management controls over financial statement reporting. Specifically, we reviewed management controls over reporting transactions for the Equipment in Use account. We also reviewed the results of management's self-evaluation of those controls.

Adequacy of Management Controls. We identified a material management control weakness, as defined by DoD Directive 5010.38, for DTSA. Management controls for DTSA were not adequate to ensure that assets no longer used were removed from the appropriate accounts. The management control weakness is also attributable to DFAS-Indianapolis because DFAS-Indianapolis does not have standard operating procedures in place to ensure that disposed of assets are removed from the appropriate accounts. Also, DFAS-Indianapolis management controls for reporting Equipment in Use transactions were not adequate to ensure that the transactions were properly capitalized or expensed. Recommendations 2.a., 2.b., and 3., if implemented, should improve the analysis of capitalizing equipment transactions and the DFAS-Indianapolis accounting and financial reporting for the Equipment in Use account. Although we identified the material management control weakness at DFAS-Pentagon, DFAS-Indianapolis assumed the accounting support work load in April 1996; therefore, Recommendation 2. is directed to DFAS-Indianapolis. A copy of the report will be provided to the senior official responsible for management controls in the Office of the Under Secretary of Defense for Policy and DFAS headquarters.

Adequacy of Management's Self-Evaluation. The DTSA acknowledges that inadequate property accountability is a condition that has not been corrected, but has not reported property accountability as a material weakness in its Annual Statement of Assurance. The DFAS-Indianapolis, in its Annual Statement of Assurance, did not report the lack of procedures for the reporting of disposed of assets by supported commands as a material weakness.

Prior Audits and Other Reviews

No prior audits or reviews have been conducted related to this specific audit objective.

Appendix B. Other Matters of Interest

Direct Funding Available. The DTSA Fund Certification Report, as of May 16, 1996, shows $456,460 of expired funds as "Direct Funding Available." Personnel from the DFAS office that previously provided accounting support for DTSA told DTSA that within 10 days after the close of the fiscal year in which the funds expired, the DFAS office would delete all unobligated balances. DTSA stated that the deletion of expired funds has not occurred, which places an added burden on DTSA when it reconciles appropriation balances.

Inspector General, DoD, Report No. 96-212, "Capitalization of DoD Fixed Assets," August 19, 1996. The report states that the DoD Components capitalized and retained in their financial records low-cost items that were below the FY 1996 capitalization threshold. The report recommends that the Under Secretary of Defense (Comptroller) and Chief Financial Officer direct DoD Components to apply only one capitalization threshold to asset accounts and to adjust financial records by purging assets below the designated threshold. DTSA has assets reported in the Equipment in Use account that were correctly capitalized under past thresholds, but would not be capitalized under the FY 1996 threshold. The Deputy Chief Financial Officer generally agreed that the recommendation had merit and stated that the capitalization issue will be evaluated as part an overall review of implementing Government-wide financial statement reporting requirements for property.

Appendix C. Equipment in Use Transactions Reviewed

We reviewed 11 transactions for equipment in use transactions subclassified by DTSA as automated data processing and word processing equipment. The DFAS-Pentagon improperly capitalized 9 of the 11 transactions and did not remove two disposed of equipment transactions from the appropriate accounts. The 11 transactions were funded using funds appropriated for Defense Operation and Maintenance or Defense Procurement. The transactions are summarized below.

Transaction Number 1. In FY 1991, Washington Headquarters Services sent Tinker Air Force Base $191,000 to be used on a contract for the DTSA procurement of an imaging system. As of FY 1995, DFAS made disbursements totaling $184,000 for the equipment. DFAS capitalized the imaging system at a value of $184,000, but should have expensed $67,000, the value of the application development. Further, DTSA has disposed of the equipment; therefore, DFAS should remove $184,000 from the applicable accounts.

Transaction Number 2. In FY 1991, Washington Headquarters Services sent the Office of Naval Research $326,000 for the project "Delta Message Handling System and Integrated Office Automation," which consisted of message handling software. The software has been upgraded several times since initial purchase. DFAS should have expensed the software because it should have been considered obsolete within 2 years.

Transaction Number 3. In FY 1991, Washington Headquarters Services sent the Central Intelligence Agency $482,000 for a procurement through the National Photographic Interpretation Center. DFAS correctly capitalized the procured equipment, an IPX system.

Transaction Number 4. In FY 1992, Washington Headquarters Services sent the Air Force $180,000 for the DTSA network upgrade procurement, which consisted of various network components. The equipment did not meet the capitalization threshold; therefore, DFAS should have expensed the equipment.

Transaction Number 5. In FY 1993, Washington Headquarters Services sent the Office of Naval Research $912,000 in support of the Delta Project Life Cycle. As of FY 1995, DFAS made disbursements totaling $885,000 for the equipment. The procurement consisted of both equipment and services. DFAS correctly capitalized the equipment, but should have expensed the services.

Transaction Number 6. In FY 1993, Defense Finance and Accounting Service-Pentagon sent the Air Force $21,000 for the procurement of a replacement system printer. DFAS correctly capitalized the equipment because the unit cost was greater than the capitalization threshold.

Transaction Number 7. In FY 1993, the Defense Finance and Accounting Service-Pentagon sent the Air Force $50,000 for the procurement of replacement workstation printers. DFAS should have expensed the equipment because the unit cost of the printers was below the capitalization threshold.

Transaction Number 8. In FY 1993, the Defense Finance and Accounting Service-Pentagon sent the Air Force $135,000 of DTSA funds for procurement of replacement DTSA Macintosh workstations. As of FY 1995, DFAS made disbursements totaling $129,000 for the equipment. DFAS should have expensed the equipment because the unit cost was below the capitalization threshold. DTSA personnel said the remaining $6,000 was canceled and not returned to DTSA.

Transaction Number 9. In FY 1993, the Defense Finance and Accounting Service-Pentagon sent the Air Force $26,000 for various automated data processing components. DFAS should have expensed the equipment because the unit cost was below the capitalization threshold.

Transaction Number 10. In FY 1993, The Defense Finance and Accounting Service-Pentagon sent the General Services Administration $20,000 for the procurement of equipment. DTSA personnel stated that the equipment consisted of maintenance and automated data processing components. The only documentation available is the military interdepartmental purchase request. Based on that information, DFAS should have expensed the equipment.

Transaction Number 11. In FY 1992, the Washington Headquarters Services sent the Air Force $75,000 to upgrade the DTSA network. As of FY 1995, $70,000 had been disbursed for the procurement. Based on available documentation, DFAS should have expensed the equipment. Further, the equipment has been disposed of; therefore, DFAS should have removed $70,000 from the applicable accounts.

Appendix D. DTSA FYs 1994 and 1995 Military Interdepartmental Purchase Requests Reviewed

Number	Fiscal Year	Document Number	Disbursed Amount
1	1994	AM40001	$ 17,000
2	1994	AM40002	18,000
3	1994	AM40003	30,000
4	1994	AM40004	43,966
5	1994	AM40005	1,000
6	1994	AM40005	8,000
7	1994	AM40006	2,500
8	1994	AM40008	23,800
9	1994	AM40009	130,000
10	1994	AM40010	11,030
11	1994	AM40011	137,000
12	1995	AM40014	120,000
13	1996	AM40023	148,000
14	1996	AM40024	65,894
15	1996	AM40025	100,000
16	1996	AM40027	850,000
17	1994	AC40472	272
18	1994	AM50001	7,000
19	1995	AM50002	62,000
20	1994	AM50003	10,000
21	1994	AM50004	710
22	1995	AM50005	22,000
23	1995	AM50006	36,820
24	1995	AM50007	25,000
25	1995	AM50008	23,795
26	1995	AM50010	30,000
27	1995	AM50011	44,000
28	1995	AM50015	12,730
29	1995	AM50019	718
30	1996	AM50021	100,000
31	1996	AM50022	530,000
32	1996	AM50023	375,421
33	1996	AM50024	22,000
34	1996	AM50025	106,000
Total			**$3,114,656**

Appendix E. Organizations Visited or Contacted

Defense Organizations

Defense Finance and Accounting Service-Indianapolis, Indianapolis, IN
  Defense Accounting Office, Arlington, VA
Defense Technology Security Administration, Arlington, VA
Washington Headquarters Services, Arlington, VA

Appendix F. Report Distribution

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- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Part III - Management Comments

Defense Finance and Accounting Service Comments

DEFENSE FINANCE AND ACCOUNTING SERVICE

1931 JEFFERSON DAVIS HIGHWAY
ARLINGTON, VA 22240-5291

OCT 16 1996

DFAS-HQ/AFB

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Management Comments on the Draft Audit Report on the Capitalization of Defense Technology Security Administration Equipment (Project No. 5RF-6010.14)

The subject report has been reviewed and our management comments are attached. Please direct any questions concerning this matter to Ms. Martha Cooper at (703) 607-5102.

Thomas F. McCarty
Deputy Director
for Accounting

Attachment

Draft Audit Report on the Capitalization of Defense Technology Security Administration Equipment
(Project No.5RF-6010.14)

Recommendation 2: We recommend that the Director, Defense Finance and Accounting Service-Indianapolis:

a. Make the appropriate data entries in the Washington Headquarters Services Allotment Accounting System upon determining whether equipment acquisitions are for capital or noncapital equipment.

Management comments to 2.a. Nonconcur. DFAS cannot make the adjustments to the Washington Headquarters Services Allotment Accounting System (WAAS). Currently, only the WAAS Systems Administrator has the capability of making adjustments. For the FY 96 reporting year, the WAAS Systems Administrator will be responsible for any asset, expense, and equity adjustments. DFAS has requested the capability to access WAAS. We have also requested that WAAS makes a distinction in its accounting records between capitalized and expensed equipment. Presently, the system does not have the capability to make adjustments on equipment line items that are being modified, loaned, or salvaged. The property book officers have the required data in their subsidiary records to assign property status as of September 30. The property book officers will retain the detailed information making up the summary level adjustments. Year-end adjustments made to the accounting records by accounting offices will be at the summary level and will only effect the equity, expense, and asset summary accounts.

Property accountability is scheduled to undergo significant changes within the Treasury Index (TI) 97 umbrella as agencies move into the Defense Property Accountability System (DPAS) environment. DPAS will provide the necessary conduit for the property book officers to collect and report property data for general ledger purposes. Regardless of the property system used, property book officers will be responsible for providing the data to the supporting accounting office.

b. Establish standard operating procedures for information required from Defense agencies so that Defense Finance and Accounting Service-Indianapolis may properly record disposed of equipment.

Management comments to 2.b: Concur. The Defense Agencies need standard operating procedures and to be cognizant on the importance of accurate property reporting for TI 97 financial statements purposes. DFAS is currently in the process of developing the communication channels with our new customers to improve the current levels of property reporting. This improvement process will take time.

TI 97 reporting must operate under the same guidelines (DFAS 37-1 and DoD Financial Management Regulations) as is required of other customers currently serviced by DFAS. The necessary operating guidance exists. We will be to ensure all parties in the TI 97 network receive, understand, recognize the importance of implementing the guidance. For the FY 1996 CFO reporting year, the WAAS System Administrator plans to consolidate and record this data in the general ledger. Furthermore, as long as WAAS serves as the supporting installation level accounting system for the Defense Technology Security Administration, a determination will be made as to the input level (system administrator or user level) required to record values reported by the property book officers. Estimated Completion Date: November 1996.

Additional Management Comments: DFAS agrees that property book officers are responsible for maintaining the subsidiary records that ultimately support equipment-in-use general ledger balances. Property book officers are required to conduct periodic inventories of all equipment-in-use items to support the balances that are carried on their property accountability records. Unfortunately, the WAAS is not capable of being modified to serve as a subsidiary ledger to the general ledger equipment-in-use balance. The cost of maintaining two subsidiary ledgers for personal and real property (one in the property book system and one in the accounting system) would be cost prohibitive and unjustifiable.

Defense Technology Security Administration Comments

DEFENSE TECHNOLOGY SECURITY ADMINISTRATION
400 ARMY NAVY DRIVE, SUITE 300
ARLINGTON, VA 22202-2884

In reply refer to:
I-96/10970

MEMORANDUM FOR DIRECTOR, READINESS AND OPERATIONAL SUPPORT DIRECTORATE, DOD IG

FROM: DIRECTOR, DEFENSE TECHNOLOGY SECURITY ADMINISTRATION
Prepared by: C. Clarke, DTSA/RM(MSD), 604-5440

OCT 7 1996

SUBJECT: DRAFT Audit Report - Project No. 5RF-6010.14, The Capitalization of DTSA Equipment

We concur with the findings of the subject draft report and the recommendation that DTSA establish accounting controls to ensure that the Equipment In Use account accurately reflects the acquisition cost of equipment placed in use.

DTSA has implemented a number of controls to improve the management of investment items. First, additional scrutiny is being added to ensure purchasing documents comply with the legislated acquisition threshold levels, that supporting documentation is readily available and properly maintained, and that data is passed to DFAS to update the "Equipment in Use" account (i.e., code purchases as capital or expense items). The billing address has been changed to DTSA's Management Support Division, in lieu of the Information Technology Division to facilitate linking of Receiving Reports (i.e., DD 1155's) with the purchase document to expedite validation of expenditures. Future requests for excess/turn-in will be listed as purchased and reference the respective purchasing documents. All requests for property management changes will be coordinated with the WHS Budget & Finance office prior to their release. The DTSA Budget Officer will notify DFAS to change these items from capitalized (i.e., Code C) to excessed (i.e., Code D). The DTSA actions addressed above will be completed by December 31, 1996.

My point of contact for this matter is Ms. Carole Clarke, Chief, Management Services Division, (703) 604-5440.

Washington Headquarters Services Comments

DEPARTMENT OF DEFENSE
WASHINGTON HEADQUARTERS SERVICES
1155 DEFENSE PENTAGON
WASHINGTON, DC 20301-1155

23 SEP 1996

MEMORANDUM FOR DoD INSPECTOR GENERAL
DIRECTOR, READINESS AND OPERATIONAL SUPPORT

SUBJECT: Audit Report on the Capitalization of Defense Technology Security Administration Equipment (Project No. 5RF-6010.14)

In reference to the subject draft audit report, the Washington Headquarters Services concurs with recommendation 1 as it relates to the WHS Allotment Accounting System (WAAS). A new data element has been added to the transaction level of the WAAS database structure to identify capital versus non-capital acquisitions in major object class 31. The new field will accept the following codes: C-capital acquisitions, D-disposed acquisitions, E-expensed acquisitions, L-equipment on loan, and P-prior period adjustments.

The codes for this new field will be entered by the WHS, Budget and Finance staff prior to the close of FY 1996. As a test for this new procedure, appropriate codes were entered into WAAS to correct the erroneous "equipment in use" transactions displayed in table 2 and table 3 of the audit report. During FY 1997, the new codes will be entered through data entry and an interactive update program will be provided for the WAAS users. Procedures for the entry of the code will be in place by December 31, 1996.

The attached memorandum dated September 4, 1996 was sent to all WAAS users that report capitalized acquisitions in their trial balances. It also provided policy and guidance on the use of the new codes and the resultant general ledger postings.

Each WAAS user was provided a listing of all transactions that procured capital acquisitions for their Agency for all active appropriations. They were requested to review the listing and report back to WHS by September 24, 1996 any corrections they desired based on their reconciliation of the accounting and logistic records. Direct any questions on this matter to Mr. William Bader at 703-614-0971.

D. O. Cooke
Director

Attachment

DEPARTMENT OF DEFENSE
WASHINGTON HEADQUARTERS SERVICES
1155 DEFENSE PENTAGON
WASHINGTON, DC 20301-1155

(Budget and Finance) September 4, 1996

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Property Accounting

As you are well aware, this will be the first year that CFO financial statements will be required for Treasury Index 97 general funds under the category of "Other Defense Organizations". Each entity's year end trial balance will be the primary source document for the preparation of these reports.

Over the past year there has been great emphasis by the DoDIG on one general ledger account, 1762 - Equipment In Use. There have been several audit reports issued in the past year addressing the difficulties that have been experienced in this area.

Generally, property accounting has been a problem for all accounting entities. In the past, the capitalization dollar threshold was minimal creating a prohibitively large volume of capitalized transactions. The threshold is now $100,000 which has diminished the number of transactions to a more manageable level. The WHS Allotment Accounting System is being changed to capture property transactions that have a material impact on the CFO financial statements.

There are cases within your accounting records where assets have been capitalized when they should have been expensed, and property that was correctly capitalized has since been lost, destroyed or disposed of. A list of currently capitalized property items for your organization is attached for your review. Request that you annotate this listing with appropriate comments, i.e. expensed, disposed, etc., and return to this office by September 24, 1996. We will make the data corrections to WAAS based on your input prior to the production of your final year end trial balance.

In order to accomplish this, a new field has been established in the WAAS database that will accept the following codes for property transactions:

C - Capitalized property
D - Previously capitalized property that has been disposed
L - Property on loan to other Organizations
P - Property capitalized that should have been expensed

At present, the data entry software will restrict user access to this field. Since we are unsure what method of access will be best for this new field, (data entry vs. direct database access), we will make your initial data corrections. We will notify you at a later date what method will be used for FY 1997 data.

The new procedure will capitalize property when an accrual transaction is recorded for direct funds if the major object class is 31 (equipment) but not equal to 3121 (furniture), a property code of "C" is used, and the dollar amount exceeds the appropriate threshold for that particular fiscal year.

In order to correct previously noted problems, the following entries will be made:

1. for property that was capitalized but should have been expensed:

DR 3100 Appropriated Capital
DR 7400 Prior Period Expenses

CR 1762 Equipment In Use
CR 5700 Appropriated Capital Used

2. for property that was correctly capitalized and has since been lost, disposed of, or destroyed:

DR 3100 Appropriated Capital
CR 1762 Equipment In Use

These changes are not intended to fulfill all requirements for property accounting, but will satisfy the problems noted in recent DoDIG audits, and provide accurate information on end of year trial balances that will be used for CFO reporting.

Please call me at 703-614-0971 if there are any questions.

William J. Bader

William J. Bader
Deputy Director

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CORPORATE INFORMATION MANAGEMENT, ATTN: RM
DoD INSPECTOR GENERAL, ATTN: BUDGET

Audit Team Members

This report was prepared by the Readiness and Operational Support Directorate, Office of the Assistant Inspector General for Auditing, DoD.

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INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Capitalization of Defense Technology Security Administration Equipment

B. DATE Report Downloaded From the Internet: 11/03/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #): OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: __VM__ **Preparation Date 11/03/99**

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.