

August 20, 2003



Financial Management

Corps of Engineers Equipment
Reporting on Financial Statements
for FY 2002
(D-2003-123)

Office of the Inspector General
of the
Department of Defense

Constitution of
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Article I, Section 9

Report Documentation Page

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Acronyms

CEFMS	Corps of Engineers Financial Management System
IG DoD	Inspector General of the Department of Defense
MARKS	Modern Army Record Keeping System
PP&E	Property, Plant, and Equipment
USACE	U.S. Army Corps of Engineers



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

August 20, 2003

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Report on the Corps of Engineers Equipment Reporting on Financial Statements for FY 2002 (Report No. D-2003-123)

We are providing this report for your information and use. We considered management comments on a draft of this report when 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 staff. Question should be directed to Mr. James L. Kornides at (614) 751-1400 ext. 211 or Mr. John K. Issel at (614) 751-1400 ext. 212. See Appendix B for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

Paul J. Granetto
Defense Financial Auditing Service
Directorate

Office of the Inspector General of the Department of Defense

Report No. D-2003-123

August 20, 2003

(Project No. D2003FJ-0050)

Corps of Engineers Equipment Reporting on Financial Statements for FY 2002

Executive Summary

Who Should Read This Report and Why? U.S. Army Corps of Engineers civil service and uniformed officers responsible for financial reporting of equipment should read this report. It discusses the management controls that are necessary to support the financial reporting of equipment on financial statements.

Background. The audit was performed in support of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. The Inspector General of the Department of Defense is required to audit the annual financial statements of organizations within the Department of Defense. This report is a result of work performed in support of the audit of the Corps of Engineers FY 2002 Financial Statements.

For FY 2002, Property, Plant, and Equipment was the most significant asset reported by the U.S. Army Corps of Engineers in its financial statements. Equipment comprised \$650.8 million of the Property, Plant, and Equipment that the U.S. Army Corps of Engineers reported. Equipment generally includes assets with an acquisition value of \$25,000 or more. It does not include land, buildings, structures, and construction-in-progress. The U.S. Army Corps of Engineers employs several different types of equipment to maintain its civil works operations such as forklifts, trucks, cranes, barges, and boats.

Results. The data the U.S. Army Corps of Engineers provided for us to use in sampling and testing the amount it reported for equipment on the FY 2002 financial statements did not include \$49.3 million of equipment assets. Additionally, the U.S. Army Corps of Engineers did not maintain adequate documentation to support all of the values that were listed for the items of equipment that we reviewed. Although we were able to verify the existence and completeness of all of the equipment that we sampled, the data and valuation problems resulted in our conclusion that the value of equipment the U.S. Army Corps of Engineers reported on the FY 2002 financial statements was not sufficiently reliable. Unless corrective actions are taken, the value of equipment will continue to be unreliable for future financial reporting periods. Implementing the recommendations would help prepare the U.S. Army Corps of Engineers for future audits and ensure the correct maintenance of equipment asset files. (See the Finding section of the report for the detailed recommendations.)

Management Comments. The U.S. Army Corps of Engineers concurred with the finding and recommendations. The Corps of Engineers stated that it will at frequent

intervals review and monitor the readiness and availability of the complete line item universe through management tools such as Command inspections. Additionally, the Corps of Engineers will issue a letter that reiterates policy for document retention. The letter will also reinforce the reconciliation between the financial records and property records. See the Finding section for a summary of management comments and the Management Comments section for the complete text of the comments.

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Background

The audit was performed in support of Public Law 101-576, the “Chief Financial Officers Act of 1990,” November 15, 1990, as amended by Public Law 103-356, the “Federal Financial Management Act of 1994,” October 13, 1994. The Inspector General of the Department of Defense (IG DoD), is required to audit the annual financial statements of the Department of Defense. This report is a result of work performed in support of the Audit of the Corps of Engineers FY 2002 Financial Statements.

The U.S. Army Corps of Engineers (USACE), Civil Works, reports General Property, Plant, and Equipment (PP&E) as a line item on the financial statements. For FY 2002, PP&E was the most significant asset category on the USACE financial statements, reported at a net value of \$36.9 billion. Equipment in the USACE principal statements in FY 2002 represents \$650.8 million of the PP&E reported on the statement.

The USACE Civil Works mission falls into four broad areas: water infrastructure, environmental management and restoration, response to natural and manmade disasters, and engineering and technical services to the Army, DoD, and other agencies. USACE uses several different types of equipment assets to perform its mission such as forklifts, trucks, cranes, barges, and boats. The equipment portion of PP&E generally includes assets with an acquisition value of \$25,000 or more. It does not include land, buildings, structures, and construction-in-progress.

The DoD Financial Management Regulation, Volume 4, chapter 6, August 2000, defines General PP&E as tangible assets that:

- have a useful life of two years or more,
- are not intended for sale,
- are acquired or constructed with the intention of being used by the entity, and
- have an initial acquisition cost, book value, or an estimated fair market value that equals or exceeds the DoD capital asset threshold.

The regulation requires that supporting documentation for the assets be maintained by the owner in a readily available location during the applicable retention period. This permits the validation of information pertaining to the asset, including acquisition cost, acquisition date, and cost of improvements.

Objectives

Our overall audit objective was to determine the reliability of the USACE, Civil Works, equipment as presented in the General PP&E line item in the FY 2002 Financial Statements. We also reviewed the management control program as it related to the overall objective. See appendix A for a discussion of the scope and methodology, and our review of the management control program.

Equipment Financial Reporting

USACE did not produce adequate information for an audit of equipment. Further, some of the documentation needed had not been retained or did not support equipment assets reported in the USACE FY 2002 Civil Works financial statements. The specific deficiencies were:

- the data provided supported \$49.3 million less equipment than that reported in the FY 2002 financial statements, and
- supporting documentation for a projected \$47.5 million of equipment assets was either unavailable or failed to match information in the automated data system.

These deficiencies were the result of improper methods used to collect the information needed for the audit. Additionally, USACE had not developed controls to ensure personnel adhered to existing policies and procedures for retaining documentation and valuing assets in the absence of historical data. During tests for physical verification and completeness of records, the audit showed that the USACE properly recorded and controlled the equipment assets we statistically sampled and reviewed. However, as a result of the weaknesses in the compilation of the data and the shortfalls in valuation documentation, we were unable to validate \$49.3 million of the USACE equipment reported on the FY 2002 financial statements, and identified an additional projected \$47.5 million that was not accurately supported. We concluded that the equipment value USACE reported on its FY 2002 financial statements is unreliable and future reported amounts will be unreliable until these weaknesses are corrected.

Equipment Universe

We determined that it would be necessary to use statistical sampling procedures to test equipment because of the large number of equipment assets. To use statistical sampling, a database or universe including all equipment assets reported for FY 2002 was needed. From this database or universe, the statisticians selected a (statistical) sample of equipment assets for our review. The results of our review of selected equipment assets (the sample) would later be used to calculate projections, which represent the overall results that are statistically probable, had we reviewed every equipment asset.

At the beginning of the audit, USACE provided two databases (the universe) in support of the equipment it reported for FY 2002. USACE indicated that the universe of equipment it provided to us included all capital equipment assets recorded in the Corps of Engineers Financial Management System (CEFMS).

Our review of the universe data identified a difference of approximately \$49.3 million between the equipment universe provided to us (\$601.5 million) and the amount reflected on the USACE FY 2002 financial statements (\$650.8 million). It was not until January 16, 2003, that USACE was able to

identify several errors it made when providing us the initial universe data. USACE included non-equipment assets in the universe and did not include all capitalized equipment assets that should have been part of the universe.

We concluded that USACE management was not prepared to provide a universe for the equipment line item at the start of the audit. To properly support an audit of equipment, USACE needed to establish all the procedures necessary to ensure the readiness and availability of the complete equipment line item universe prior to the start of audit.

Supporting Documentation

USACE could not provide documentation to support all of the equipment values that we reviewed. We used a statistical sample to select equipment for review and projected the number and value of equipment assets that were not adequately supported.

From the USACE universe of equipment provided to us, we statistically selected 788 equipment assets at 14 USACE district offices for review. See Appendix A for our statistical sampling plan and results.

The following table details the sites visited and number of equipment assets reviewed at each site.

Districts Selected for Review

<u>USACE District Office</u>	<u>Number of Assets Reviewed</u>
Buffalo	20
Huntington	20
Little Rock	20
Louisville	100
Memphis	140
Mobile	20
Nashville	20
New Orleans	120
Portland	100
St. Louis	40
St. Paul	40
USACE HQ	8
Vicksburg	120
Waterways	20
14 Districts	788

Based on results of the sample, we concluded that the USACE offices did not always have documentation to support values recorded for equipment. We projected that the statistical midpoint of equipment values that were not adequately supported was \$47.5 million.

Document Retention. The primary reason for the unsupported values was that the USACE district offices did not maintain documentation for a long enough time period. USACE offices did not consistently maintain the documentation needed to support the assets' value over the assets' entire useful (or depreciable) life. We projected that 429 of 6,017 assets in the universe would have had no supporting documents had we examined all of them. Examples of situations with no supporting documentation follow.

- We reviewed CEFMS records that described a crane barge that the Vicksburg District purchased for \$3,502,297 on November 1, 1995. The barge's net book value reported on the financial statements was \$2,896,657. The District did not maintain supporting documentation for the stated value.
- Our sample also included a cargo barge located at the St. Paul District that was purchased November 1, 1987, for \$128,651. At the end of FY 2002, its net book value reported as part of equipment on the financial statements, was \$80,675. Personnel at the St. Paul District office could not provide any documentation supporting the value of the barge.
- The Vicksburg sample included a dump truck, that the automated system showed was purchased on June 25, 2002, for \$78,467. Its net book value was reported as \$76,833. The Vicksburg District did not have supporting documentation for the value even though the asset was less than a year old.

The USACE Districts responsible for these assets and others with no historical supporting documentation needed to revalue them and retain the supporting documentation.

System Records. In a significant number of cases, the supporting documentation that was located and provided by USACE district offices did not match the records in CEFMS. We projected that there would be 162 equipment assets out of 6,017 in the universe for which hard copy documents would not match CEFMS records. The errors occurred for a number of reasons, including inappropriately long lag periods between receipt of an asset and entry into CEFMS, and incorrect acquisition prices recorded in CEFMS.

The following examples illustrate mismatches between CEFMS information and supporting documentation.

- In preparation for the audit, the St Louis District reviewed its files on items in our sample. The review included a small boat that was purchased April 30, 1993, for \$546,586. The review of the hard copy files identified \$420,120 of additional costs for the boat that should have been

capitalized. District personnel stated that CEFMS records would be corrected for FY 2003 reporting.

- At the Louisville District, CEFMS records indicated a towboat was purchased January 20, 1997, for \$607,426. Our review of the original documents showed that the boat was actually purchased 20 months earlier on April 25, 1995. District personnel agreed to change the acquisition date in CEFMS, which resulted in an adjustment of \$40,544 that decreased the net value of the boat.
- In the Memphis District we reviewed a laser plotter with a net book value of \$11,730, which we identified as an overstatement. A review of the files showed that the acquisition price of \$31,081 was not fully supported, nor was the date in CEFMS supported. The CEFMS date of June 1, 1993, was 21 months prior to the date listed on the supporting documentation. Additionally, the depreciation was calculated over an incorrect time period. The asset should have been fully depreciated as of April 2002.

In all of these cases, CEFMS should accurately reflect hard copy historical documentation.

Implementing Policies

As part of the audit we evaluated policies that affect management of documentation that supports equipment values. We concluded that existing DoD policies and additional interim policies were available to guide USACE offices in the retention of sufficient documentation. However, the USACE district offices were not following the policies and were not retaining documentation to support equipment assets for their entire useful life.

Existing DoD Policy. DoD Financial Management Regulation, Volume 4, chapter 6, addresses document retention, as do several other policies. Army Regulation 25-400-2, the “Modern Army Record Keeping System (MARKS)” dated October 1, 2001, is used by USACE to properly manage information, from its creation through final disposition, according to Federal laws and Army record-keeping requirements. This regulation furnishes the only legal authority for destroying nonpermanent Army information and provides life cycle management instructions for the systematic identification, maintenance, storage, retirement, and destruction of Army information recorded on any medium (paper, microforms, electronic, or any other). The current MARKS requirement (also cited in Engineer Regulation 37-1-29, dated November 30, 2002) for maintaining documentation for capitalized assets is 10 years after the disposal of the asset.

Interim Policy. In addition to existing DoD policies, USACE Headquarters issued interim guidance in the form of memorandums dated May 1996, and January 1999, detailing requirements for maintaining documents for revolving fund assets “until the asset is retired or otherwise disposed of.” The 1999 memo extended the retention period to three years after the end of the fiscal year in which the asset is disposed of. It also provided guidance for determining the

value of assets acquired before June 1, 1996, for which historical cost documentation was not available.

According to the memorandum, acceptable procedures for valuing assets for which historical cost documentation was no longer available included:

- current working estimates prepared for the acquisition,
- appropriation or other Congressional information;
- Plant Replacement and Improvement Program documentation;
- development of an estimate based on the cost of similar assets at the time of original acquisition; and
- current cost of similar assets, discounted for inflation since the time of acquisition.

There were several reasons why the policy was not effectively followed. The principal reasons were that USACE Headquarters had not developed controls to measure and ensure the implementation of existing policy, and management had not tested adherence to the policies and procedures that the divisions and districts should have been following.

The USACE needed to develop control procedures that ensured the existing policies were effectively implemented. The control procedures should include provisions to value and document equipment for which no historical documentation exists, and use data from existing documents to correct the data in the automated information system in those cases where incorrect information has been recorded.

Results of Existence Tests of Equipment

Our test of the existence of USACE equipment assets showed that all 788 of the items we selected for review at the 14 Districts and Divisions were recorded on USACE records, and that those assets existed at USACE locations we visited. While performing our physical verification fieldwork, we judgmentally selected an additional 223 equipment assets used to perform a completeness test. Our review of the completeness of the USACE records showed that the 223 equipment assets in the field were recorded in the records. We found no errors during those tests.

Conclusion

Although USACE had properly recorded and controlled the reviewed equipment assets for which it has responsibility, USACE inability to produce data needed for our audit, along with the lack of adequate supporting documentation, resulted in our conclusion that the equipment value on the FY 2002 financial statements is not sufficiently reliable. Future reported amounts will also be unreliable unless these issues are resolved. In the future, it is essential that USACE be prepared to provide auditors with a complete database, or universe, that fully supports the

amount shown as equipment in its financial statements. USACE policy concerning supporting documentation retention should be fully implemented and equipment for which no supporting documentation exists should be valued and documented. Additionally, automated information system data should be corrected to accurately reflect the data in the hard copy documentation.

Recommendations and Management Comments

We recommend that the Commander, U.S. Army Corps of Engineers, direct the Director of Civil Works to:

- 1. Establish procedures necessary to ensure the readiness and availability of the complete equipment line item universe prior to the start of audit.**

USACE Comments. The Corps of Engineers concurred. The Corps of Engineers will continually review and monitor the readiness and availability of the complete line item universe through management tools such as Command inspections.

- 2. Finalize interim policy and fully implement existing DoD and U.S. Army Corps of Engineers policy and value and document equipment for which no historical documentation exists, and correct automated information system data to reflect correct data from hard copies.**

USACE Comments. The U.S. Army Corps of Engineers concurred. The Corps of Engineers will issue a letter that reiterates policy for document retention. The letter will also reinforce the reconciliation between the financial records and property records.

Appendix A. Scope and Methodology

We reviewed information related to the USACE financial statement reporting of equipment assets valued at \$650,783,394 for FY 2002. We used a statistical sample of capital assets (generally \$25,000 or greater) recorded in the CEFMS database. Our sample included 788 items. We also made inquiries of personnel from the USACE Headquarters and 14 district offices.

We performed this audit from October 2002 through March 2003 in accordance with generally accepted government auditing standards.

At the start of the audit, the USACE provided us a database of the capital equipment assets recorded in CEFMS. We decided to statistically select a sample of assets for review from the population of 6,017 assets representing \$571,279,949 (or 95 percent) of capital equipment recorded in CEFMS for FY 2002. We did not review an additional database of 828 assets valued at \$30,250,741 consisting of mostly USACE computer system assets, due to time constraints. (\$571.3 million + \$30.2 million = \$601.5 million)

A two-stage sample design was developed and used. At the first stage, Field Operating Activity was selected as a sampling point and its selection was based on the reported dollar value using a probability proportional to size with replacement methodology. At the second stage, a stratified design was used and two strata were selected. The first stratum was a census of items with net values greater than or equal to \$2 million. The second stratum consisted of the remainder of non-census items. Items in the second stratum were chosen by simple random selection without replacement.

The determination of an appropriate sample size was based on information from prior audit work and professional judgment. The statistical selection resulted in a sample of 788 assets located at 14 USACE offices.

Our statisticians calculated the following projections for the \$571,279,949 of capital equipment the USACE reported for FY 2002. The projections were calculated using information we supplied on the equipment assets that we determined had values that were not adequately supported.

**Table 1. Projection of the Value of Equipment Assets
Not Adequately Supported**

	<u>Lower Bound</u>	<u>Point Estimate</u>	<u>Upper Bound</u>
Not Adequately Supported	\$12,791,945	\$47,489,483	\$82,187,021
No Documentation	\$ 3,852,866	\$29,932,583	\$56,012,299
System Inaccuracy	\$ 2,913,274*	\$17,556,901	\$38,202,477

* The lower bound is the actual dollar error in the sample and is not a statistically projected amount.

We are 95 percent confident the total of dollars not adequately supported is between \$12,791,945 and \$82,187,021. We statistically projected the dollars not adequately supported into two categories: no documentation and system inaccuracy. We are 95 percent confident the total of no documentation dollars is between \$3,852,866 and \$56,012,299. We are 95 percent confident the total of system inaccuracy dollars is between \$2,913,274 (actual dollar error) and \$38,202,477.

We statistically projected to the population of 6,017 items the number of errors for the “not adequately supported”, “no documentation” and “system inaccuracy” categories. Since the sample design for this project was initially developed for variable (dollar) estimates, the relative precision associated with the attribute projections at the 95% confidence level is high.

Table 2. Projection of the Number of Equipment Assets Not Adequately Supported

	<u>Lower Bound</u>	<u>Point Estimate</u>	<u>Upper Bound</u>
Not Adequately Supported	213	591	968
No Documentation	103	429	755
System Inaccuracy	65	162	260

We are 95 percent confident the number of equipment assets not supported is between 231 and 968. We are 95 percent confident the number of equipment assets with no documentation is between 103 and 755. We are 95 percent confident the number of assets inaccurately reflected in the system is between 65 and 260 equipment assets.

Use of Computer-Processed Data. We relied on computer-processed data from CEFMS to determine the districts to be visited and the audit sample selections. We did not test the general and application controls of the system and we considered this in determining our sample selection population. We performed other tests on the data to determine the accuracy and reliability of the Equipment account balances. 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 in this audit report.

Use of Technical Assistance. We received assistance from the Quantitative Methods Division in the Office of the Inspector General of the Department of Defense. Specifically, we had help determining our statistical sampling plan and also in the statistical analysis and projection of our audit results.

General Accounting Office High-Risk Area. The General Accounting Office has identified several high-risk areas in DoD. This report provides coverage of the financial management high-risk area.

Management Control Program Review

DoD Directive 5010.38, “Management Control (MC) Program,” August 26, 1996, and DoD Instruction 5010.40, “Management Control (MC) Program Procedures,” August 28, 1996, require 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 the Review of the Management Control Program. We reviewed the adequacy of USACE management controls over the financial reporting of equipment. Specifically, we reviewed USACE management controls over data gathering to provide a complete universe and efficiency in maintaining supporting documentation for equipment assets records and files. We reviewed management’s self-evaluation applicable to those controls.

Adequacy of Management Controls. We identified material management control weaknesses for USACE as defined by DoD Instruction 5010.40. USACE management controls over the financial reporting of equipment were not adequate to ensure that a complete universe was provided, and that equipment files were properly maintained to include historical documentation for the life of an asset. Recommendations in this report, if implemented, will correct the identified weaknesses and could result in reliable financial statement reporting for equipment. A copy of the report will be provided to the senior official responsible for management controls in the USACE.

Adequacy of Management’s Self-Evaluation. Management’s self-evaluation did not identify financial management nor specifically equipment valuation as an assessable unit, and therefore, did not identify or report the material management control weakness identified during the audit.

Prior Coverage

During the last 5 years, the Army Audit Agency published one report on the USACE, Civil Works - equipment. Army Audit reports can be accessed at <https://www.aaa.army.mil/reports/.htm>, which is accessible on the extranet to military domains and GAO only.

Army

AAA Report No. AA-02-142, “Fiscal Year 2001 Financial Statements US Army Corps of Engineers, Civil Works,” February 08, 2002

Appendix B. Report Distribution

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U.S. Army Corps of Engineers Comments

Final Report
Reference



DEPARTMENT OF THE ARMY
U.S. ARMY CORPS OF ENGINEERS
WASHINGTON, D.C. 20314-1000

REPLY TO
ATTENTION OF:

CELD-MS (735-5)

JUL 29 2003

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE,
400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-4704

SUBJECT: Report on the Corps of Engineers Equipment Reporting on Financial Statements for
FY 2002 (Project No. D2003FJ-0050)

1. Reference memorandum, 4 June 2003, SAB.
2. Headquarters, U.S. Army Corps of Engineers' comments for each specific recommendation are as follows:

a. Recommendation 1 – Establish procedures necessary to ensure the readiness and availability of the complete line item universe prior to the start of audit.

Command Comments: Concur. U.S. Army Corps of Engineers will monitor and review recommendation continually through management tools such as Command Inspections, Command Management Reviews and the Command Supply Discipline Program.

b. Recommendation 2 – Finalize interim policy and fully implement existing DoD and U.S. Army Corps of Engineers policy and value and document equipment for which no historical documentation exists, and correct automated information system data to reflect correct data from hard copies.

Command Comments: Concur. Our action plan is designed to address and comply with Chief Financial Officers Act requirements. This effort is focused on policy guidance and automation tools to enable vertical and horizontal visibility of business processes and information. It incorporates the tenets of subject Report, which identified that policy direction is in-place but field compliance is lacking.

Command will issue a letter that will reiterate policy and procedures for document retention. It will also reinforce the need for reconciliation between the financial records within Corps Engineers Financial Management System and the Automated Personal Property Management System. This policy guidance will be incorporation into the next update of ER 700-1-1, USACE Supply Policies and Procedures, and ER 37-2-10, Financial Administration – Accounting and Reporting – Civil Works Activities.

3. The action plan is enclosed which identifies current actions taken to resolve the deficiencies identified in the report.

* Omitted

*Omitted because of length. Copies will be provided upon request.


CELD-MS
SUBJECT: Report on the Corps of Engineers Equipment Reporting on Financial Statements for
FY 2002 (Project No. D2003FJ-0050)

4. POC for this action is Debra Simms, CELD-MS, 202/761-8772.

FOR THE COMMANDER:

Encl
as

cf:
CERM



JOHN E. TEMPLETON
Chief, Internal Review

Team Members

The Defense Financial Auditing Service Directorate, Office of the Deputy Inspector General for Auditing of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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