

March 15, 2006



# Financial Management

## Internal Controls Over Compiling and Reporting Environmental Liabilities Data (D2006-062)

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1. REPORT DATE <b>15 MAR 2006</b>	2. REPORT TYPE	3. DATES COVERED <b>00-00-2006 to 00-00-2006</b>	
4. TITLE AND SUBTITLE <b>Financial Management: Internal Controls Over Compiling and Reporting Environmental Liabilities Data</b>		5a. CONTRACT NUMBER	
		5b. GRANT NUMBER	
		5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)		5d. PROJECT NUMBER	
		5e. TASK NUMBER	
		5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>ODIG-AUD (ATTN: AFTS Audit Suggestions), Inspector General of the Department of Defense, 400 Army Navy Drive (Room 801), Arlington, VA, 22202-4704</b>		8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)		10. SPONSOR/MONITOR'S ACRONYM(S)	
		11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>			
13. SUPPLEMENTARY NOTES			
14. ABSTRACT			
15. SUBJECT TERMS			
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>	<b>Same as Report (SAR)</b>
			18. NUMBER OF PAGES <b>39</b>
			19a. NAME OF RESPONSIBLE PERSON

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### **Acronyms**

AFRIMS	Air Force Restoration Information Management System
AFRPA	Air Force Real Property Agency
BEC	Base Environmental Coordinator
BRAC	Base Realignment and Closure
DERP	Defense Environmental Restoration Program
DUSD (I&E)	Office of the Deputy Under Secretary of Defense, Installation and Environment
FMR	Financial Management Regulation
GAO	Government Accountability Office
IRP	Installation Restoration Program
MIS	Management Information System
MMRP	Military Munitions Response Program
OMB	Office of Management and Budget
RACER	Remedial Action Cost Engineering Requirements
SAF/FM	Assistant Secretary of the Air Force, Financial Management and Comptroller



INSPECTOR GENERAL  
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March 15, 2006

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS/RESOURCES AND  
ANALYSIS  
DEPUTY UNDER SECRETARY OF DEFENSE  
(INSTALLATIONS AND ENVIRONMENT)  
ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on Internal Controls Over Compiling and Reporting Environmental  
Liabilities Data (Report No. D-2006-062)

We are providing this report for review and comment. Comments from the Assistant Secretary of the Air Force (Financial Management and Comptroller) were received too late to be considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Therefore, if the Assistant Secretary of the Air Force (Financial Management and Comptroller) does not submit additional comments by March 29, 2006, we will consider the comments received as the response to the final report.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to [Auddfs@dodig.mil](mailto:Auddfs@dodig.mil). Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Barbara A. Sauls at (703) 325-5782 (DSN 221-5782) or Ms. Monica M. Harrigan at (703) 325-5930 (DSN 221-5930). See Appendix F for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, appearing to read "Paul J. Granetto".

Paul J. Granetto, CPA  
Assistant Inspector General  
Defense Financial Auditing  
Service

## Department of Defense Office of Inspector General

Report No. D-2006-062

March 15, 2006

(Project No. D2005-D000FH-0062.000)

### Internal Controls Over Compiling and Reporting Environmental Liabilities Data

#### Executive Summary

**Who Should Read This Report and Why?** DoD civilians and uniformed officers responsible for environmental cost estimating and financial reporting should read this report. It discusses internal controls over compiling and reporting cost-to-complete estimates for environmental liabilities included in the Air Force annual financial statements.

**Background.** This audit is required by Public Law 101-576, Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. This report discusses the adequacy of internal controls used to compile and report \$7.4 billion of environmental liabilities and environmental disposal liabilities data on Note 14 of the Air Force FY 2004 Annual Financial Statements. Specifically, we address the adequacy of the control environment and control activities over compiling Defense Environmental Restoration Program and non-Defense Environmental Restoration Program data for active installations, and Base Realignment and Closure data for inactive installations. Environmental liabilities include estimated amounts for future cleanup of contamination resulting from waste disposal methods, leaks, spills, and other past activities that have created public health or environmental risks. Two Components within the Air Force are responsible for calculating and reporting cost-to-complete estimates for environmental liability data in Note 14 of the annual financial statements. Headquarters, United States Air Force Office of the Civil Engineer Environmental Division manages and reports Defense Environmental Restoration Program and non-Defense Environmental Restoration Program cost-to-complete environmental liability estimates for active installations. The Air Force Real Property Agency manages and reports cost-to-complete environmental liability estimates for Base Realignment and Closure installations. In performance and accountability reports for FYs 2002, 2003, and 2004, DoD identified environmental liabilities as a systemic management control weakness as defined by the Federal Managers' Financial Integrity Act.

**Results.** The Air Force did not have adequate internal controls over the compilation of cost-to-complete environmental liabilities estimates reported for active and Base Realignment and Closure installations. As a result, cost-to-complete estimates used in support of environmental liabilities and disposal liabilities by the Air Force active and Base Realignment and Closure installations were unreliable.

By recognizing and accepting the proper level of risk associated with reporting cost-to-complete estimates for environmental liability data, training personnel to compile reliable and accurate cost-to-complete estimates for environmental liability data, and providing oversight throughout the organization, the United States Air Force Office of The Civil

Engineer Environmental Division could improve its control environment. Evaluating the uniformity of control activities outlined in Office of Management and Budget Circular A-123, Revised June 21, 1995, "Management Accountability and Control," defining key internal control standards, and establishing a process for the preparation and compilation of cost-to-complete estimates for environmental liabilities could improve the control activities of active installations and major commands reporting environmental liability data. Defining the implementation of existing key internal control standards could strengthen the control activities at Base Realignment and Closure installations reporting to the Air Force Real Property Agency (see finding A).

Headquarters, United States Air Force Office of The Civil Engineer Environmental Division management control program did not identify material weaknesses related to reporting cost-to-complete estimates for environmental liabilities (finding B). Headquarters, United States Air Force Office of The Civil Engineer Environmental Division should perform periodic assessments of the internal controls and report the material weaknesses (as identified in finding A of this report) in their annual statement of assurance until corrected. See the Finding sections of this report for details on our recommendations.

See Appendix D for other matters of interest regarding the Military Munitions Response Program, non-Defense Environmental Restoration Program information management systems, quarterly reporting, and corrective actions taken by the Air Force Real Property Agency.

**Management Comments.** We provided a draft of this report on December 9, 2005. Management comments were received too late to be incorporated into the final report. If the Assistant Secretary of the Air Force (Financial Management and Comptroller) wishes to make additional comments on the report, he should submit them by March 29, 2006.

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## Background

**Reporting Requirement.** According to Public Law 101-576, Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, each executive agency must prepare and submit a financial statement for the preceding fiscal year to the Director of Office of Management and Budget. The Chief Financial Officers Act requires that financial statements prepared by an agency be audited by the Inspector General in accordance with generally accepted government auditing standards. Environmental liabilities include estimated amounts for future cleanup of contamination resulting from waste disposal methods, leaks, spills, and other past activities that have created public health or environmental risks. This report discusses the adequacy of internal controls used to compile cost-to-complete estimates associated with environmental liabilities and disposal liabilities data on Note 14 of the Air Force 2004 Annual Financial Statements. DoD identified, in performance and accountability reports for FYs 2002, 2003, and 2004, environmental liabilities as a systemic management control weakness as defined by the Federal Managers' Financial Integrity Act.

**Financial Management Regulation.** DoD Regulation 7000.14-R, Financial Management Regulation (FMR), volume 4, chapter 13, "Environmental and Non-environmental Liabilities," September 2002, prescribes the accounting policy and principles for measuring and recognizing DoD liabilities associated with the disposition of property, structures, equipment, munitions, and weapons. It also prescribes the accounting policy and principles for recognizing and measuring environmental liabilities associated with corrective actions and with future closure of facilities on active installations. FMR volume 4, chapter 13, also sets policy for recognizing and measuring liabilities for environmental response actions at operational test and training ranges on active installations. FMR volume 4, chapter 14, "Accrued Defense Environmental Restoration Program (DERP) Liabilities," September 2002, prescribes policies and principles for recognizing and measuring DoD liabilities associated with the containment, treatment, or removal of contamination that could pose a threat to public health and the environment. FMR volume 4, chapter 14, also states that liability recognition must not be based on the availability of funds. Both chapters 13 and 14 of the FMR stipulate that cost estimates of environmental disposal and restoration activities be subject to audit.

**DERP.** Section 211 of the Superfund Amendments and Reauthorization Act of 1986 established DERP. The goals of the program include:

- the identification, investigation, research and development, and cleanup of contamination from hazardous substances, pollutants, and other contaminants;
- correction of other environmental damage, that creates an imminent and substantial endangerment to the public health and welfare or to the environment; and

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- demolition and removal of unsafe buildings and structures, including buildings and structures of the DoD at sites formerly used by or under the jurisdiction of the Secretary.

Environmental restoration activities that occur under DERP fall into one of three program categories: Installation Restoration Program (IRP), Military Munitions Response Program (MMRP), and Building Demolition/Debris Removal Program.

The Office of the Deputy Under Secretary of Defense for Installations and Environment (DUSD [I&E]) provides, operates, and sustains installation assets and services necessary to support U.S. Military forces. DUSD (I&E) developed the DERP Management Guidance, September 2001, to serve as a companion to DoD Instruction 4715.7, "Environmental Restoration Program," April 22, 1996. Instruction 4715.7 implements and refines policies, assigns responsibilities, and prescribes procedures for the DERP and the Base Realignment and Closure (BRAC) environmental restoration program. DoD's environmental restoration account provides funding for DERP environmental liabilities; BRAC funds its own environmental restoration program. The DERP Management Guidance provides additional guidelines for implementing environmental restoration at active installations, facilities subject to BRAC, and Formerly Used Defense Sites; determining cost-to-complete estimates; and reporting financial data of environmental restoration liabilities.

In February 2003, the Air Force Civil Engineer Environmental Restoration Branch (Restoration Branch) issued, "Management Guidance for the United States Air Force Environmental Restoration Program," which provides programmatic guidance for estimating the cost-to-complete restoration of environmental liabilities for DERP projects on active installations and BRAC facilities.

**Air Force Non-DERP.** Federal, State, and local environmental laws and regulations, such as the Resource Conservation and Recovery Act of 1976 and Environmental Protection Agency requisites, are the basis for non-DERP environmental project requirements. In FY 2004, the FMR and Air Force Instructions were the only guidance available. At the time of our fieldwork, specific guidance for the management and reporting of non-DERP environmental liabilities was not available from DUSD (I&E), the office responsible for issuing DoD environmental guidance. The Quality Branch, which falls under the office of The Air Force Civil Engineer, is responsible for the oversight of the Air Force non-DERP activities. Instructions from the Quality Branch provided guidance on calculating:

- cost-to-complete estimates for Non-Environmental Restoration Accounts,
- closure cost for Resource Conservation and Recovery Act Treatments,
- closure cost for permitted landfills and storage and disposal facilities, and
- closure cost for Resource Conservation and Recovery Act-regulated underground storage tanks.

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The Quality Branch instructions required active installations and major commands to calculate cost-to-complete estimates from July to August 2004 using Remedial Action Cost Engineering Requirements (RACER).

**Reporting Responsibilities.** Headquarters, United States Air Force Office of The Civil Engineer Environmental Division (Air Staff) and the Air Force Real Property Agency (AFRPA) are responsible for reporting the cost-to-complete estimates for environmental liability data used in Note 14 of the annual financial statements. Air Staff manages DERP and non-DERP funds for environmental liability activities at active installations and major commands. AFRPA manages BRAC funds for BRAC environmental liability activities.

**Air Staff.** Air Staff oversees the Air Force environmental restoration efforts and sets the overall strategy, objectives, and policy for the program. Air Staff delegated specific oversight and approval tasks to the Integration Branch, Quality Branch, and Restoration Branch. According to Restoration Branch personnel, Air Staff reports DERP funded environmental liabilities for active installations using the Air Force Restoration Information Management System (AFRIMS), an automated management system with security controls. AFRIMS generates cost-to-complete information similar to the RACER system with the additional capability of producing the Air Force restoration budget data such as the President's Budget and Budget Estimate Submission, program objective memorandums, cost and schedule to complete, and the annual Report to Congress. As a reporting tool, AFRIMS is capable of generating reports documenting areas of concern, site data, installation expenditure data, major command data, and relative risk data. AFRIMS does not track or manage non-DERP funded environmental liability activities; instead, Quality Branch personnel require active installations and major commands to collect non-DERP funded environmental liabilities using a uniform Excel spreadsheet.

**AFRPA.** The AFRPA Environmental Restoration Division allocates cleanup funds and oversees the execution of the program by issuing guidance to BRAC installations. AFRPA reports BRAC funded environmental liability activities using the Management Information System (MIS). MIS is a web-based programming and data management system with security controls designed for the BRAC program. MIS manages installation site cleanup schedules, program funds planning, project funding execution, and financial resources. In addition, MIS generates status, progress, performance, and other user-defined reports, as well as formal data exports to meet administrative and regulatory requirements.

**Remedial Action Cost Engineering Requirements.** RACER is a cost estimating tool used to estimate DERP, non-DERP, and BRAC environmental restoration costs. The Air Force Civil Engineering Support Agency planned and funded the development and modifications of RACER, and completed the verification, validation, and accreditation of RACER in June 2001. The Air Force uses RACER to develop the cost-to-complete environmental estimates for the annual budget as well as estimates for environmental liabilities associated with future years (out-years).

**Note 14 of the Annual Financial Statements.** Note 14 of the Air Force FY 2004 Annual Financial Statements discloses additional information to the Balance

Sheet on Environmental Liabilities and Disposal Liabilities. Note 14 data independently detail environmental liabilities funded through DERP, non-DERP, and BRAC. DERP funded activities include “Environmental Restoration” and “Environmental Restoration for Closed Ranges.” Non-DERP funded activities include “Environmental Corrective Action” and “Environmental Closure Requirements.” BRAC funded activities include “Environmental Restoration” and “Environmental Corrective Action.” As of FY 2004, the Air Force no longer reports disposal liabilities. The Defense Authorization Act of 1986 transferred the accounting responsibility for all disposal costs to the Department of the Army for inclusion in their financial statements.

As of September 30, 2004, the Air Force reported \$549 million in “current environmental liabilities” and \$6.8 billion in “noncurrent environmental liabilities.” Current environmental liabilities represent obligations that are reasonably expected to be settled during the next fiscal year. Noncurrent environmental liabilities represent obligations that are not expected to be liquidated within that fiscal year. Therefore, in Note 14 of the FY 2004 Annual Financial Statements, the amounts reported as current liabilities represent environmental costs to be paid in FY 2005. Table 1 outlines the Air Force environmental liabilities by funding categories and current and noncurrent status.

	<b><u>Current Liability</u></b>	<b><u>Noncurrent Liability</u></b>	<b><u>Total</u></b>
<b>DERP</b>	\$397,368	\$5,172,703	\$5,570,071
<b>Non-DERP</b>	6,177	288,491	294,668
<b>BRAC</b>	<u>145,811</u>	<u>1,376,637</u>	<u>1,522,448</u>
<b>Total</b>	<b>\$549,356</b>	<b>\$6,837,831</b>	<b>\$7,387,187</b>

## Objectives

Our overall audit objective was to assess internal controls associated with compiling the financial data that are reported within financial statements in accordance with Federal financial accounting standards. Specifically, we assessed the control environment and control activities for reporting environmental liabilities and disposal liabilities. We also reviewed the management control program as it related to the audit objectives. See Appendix A for a discussion of the scope and methodology. See Appendix B for prior coverage related to the objectives.

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## Managers' Internal Control Program

DoD Directive 5010.38, "Management Control Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control 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 the Air Force DERP, non-DERP, and BRAC management controls over cost-to-complete estimates for environmental liabilities reported on the annual financial statements. Specifically, we reviewed management controls over audit trails and documentation, segregation of duties, supervisory reviews, management of human capital, and the overall process used to prepare, review, and submit cost estimates for inclusion in the annual financial statements. We reviewed management's self-evaluation process applicable to those controls.

**Adequacy of Management Controls.** We identified material management control weaknesses for the Air Force as defined by DoD Instruction 5010.40. The Air Force DERP, non-DERP, and BRAC management controls for environmental liabilities were not adequate to ensure reliability of the data and processes used by the Air Force to report cost-to-complete environmental liability estimates. The DoD Performance and Accountability Reports for FYs 2002, 2003, and 2004 identified environmental liabilities as a systemic management control weakness as defined by the Federal Managers' Financial Integrity Act. Recommendations A and B, if implemented, will improve the reliability of reported environmental liability estimates. A copy of this report will be provided to the Office of the Assistant Secretary of the Air Force, Financial Management and Comptroller (SAF/FM).

**Adequacy of Management's Self-Evaluation.** Air Staff did not identify or report the material management control weaknesses identified by the audit. Air Staff neither collected, reviewed, nor compiled management control programs from active installations or major commands for input into the Air Force Office of the Civil Engineer FY 2004 Annual Statement of Assurance. However, we did obtain documentation for the management control program from the Air Force Materiel Command. AFRPA, the official reporting agency for BRAC, did identify cost-to-complete estimates for environmental liabilities as an assessable unit and disclosed associated material weaknesses in its management control program. A copy of this report will be provided to the senior official responsible for management controls in the Office of the Deputy Air Force Civil Engineer for Installation, Logistics, and Engineering.

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## A. Adequacy of Air Force Internal Controls

The Air Force did not have adequate internal controls over the compilation and reporting of cost-to-complete estimates for environmental liabilities reported in Note 14 of the annual financial statements for active and BRAC installations. The internal controls were inadequate because Air Force did not promote the development of a positive control environment for active installations and enforce sound internal control activities at active and BRAC installations. Specifically, for the control environment, the Air Staff:

- considered the process of reporting cost-to-complete estimates for environmental liabilities as a low risk,
- did not commit to training personnel who report cost-to-complete estimates for environmental liabilities, and
- did not provide oversight throughout the organization to ensure that proper operating activities and reporting relationships existed.

The deficiencies identified in the control activities at both active and BRAC installations included areas of:

- audit trails and documentation,
- segregation of duties,
- supervisory reviews,
- management of human capital, and
- the process for reviewing and reporting restoration cost.

As a result, the Air Force did not provide reasonable assurance that personnel complied with applicable laws and regulations related to estimating environmental liabilities. Also, the cost-to-complete estimates used in support of environmental liabilities and disposal liabilities by the Air Force were unreliable.

## Internal Controls Standards

**Government Accountability Office Standards.** The Government Accountability Office (GAO), “Standards for Internal Control in the Federal Government,” November 1999, defines internal controls as an integral component of an organization’s management that provides reasonable assurance of the achievement of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. A positive control environment

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provides discipline and structure, as well as the climate which influences the quality of internal controls. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of Government resources and achieving effective results. Appendix C contains examples of internal control practices.

**Office of Management and Budget Standards.** Office of Management and Budget (OMB) Circular A-123, Revised June 21, 1995, "Management Accountability and Control," developed general and specific management control standards based on GAO's Standards of Internal Control. OMB Circular A-123 defines management controls as the organization, policies, and procedures used to provide reasonable assurance of the following:

- programs achieve their intended results;
- resources are used consistent with agency mission;
- programs and resources are protected from waste, fraud, and mismanagement;
- laws and regulations are followed; and
- reliable and timely information is obtained, maintained, reported and used for decision making.

**DoD Standards.** DoD has issued guidance that supports the need for effective internal controls as defined by GAO standards and OMB Circular A-123. The FMR, DERP Management Guidance, Air Force Management Guidance, and Air Force Instructions contain requirements for maintaining audit trails, documentation, and evidence of internal control procedures. Key accounting requirements of the FMR state the following.

- Accounting systems must have adequate internal controls to prevent, detect, and correct errors and irregularities that may occur throughout the system.
- Separation of duties and responsibilities must be maintained for initiating, authorizing, processing, recording, and reviewing transactions.
- Audit documentation must exist at the time of an audit.
- Environmental liability estimates must have audit trails to allow transactions to be traced from the point of initiation to the final report.

A fundamental requirement of an audit trail is that all transactions be adequately supported with pertinent documents and source records, including a narrative providing sufficient explanation for the basis of the estimate, the date prepared, the preparer's name, and evidence of supervisory approval.

DERP Management Guidance expounds on this requirement and establishes additional requirements. Section 15.8.2 requires the development and

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implementation of a formal document tracking process that allows for the identification and tracking of all changes made to a document from the point of creation through its use in the final report. A formal process for tracking documentation must identify data resources, the estimating method accreditation, and the rationale used. Components must also retain the associated management review documentation. Section 15.8.1 requires Components to develop and implement formal training programs to include introductory and recurring refresher training for staff that develop cost-to-complete estimates or prepare environmental restoration liability reports. As part of the audit trail for the annual financial statement, Components must maintain documentation that staff received this training.

Air Force Instruction 32-7020, "The Environmental Restoration Program," February 7, 2001, implements the DERP and incorporates cost-to-complete requirements outlined in the FMR. Air Force Instruction 65-201, "Management Control," May 1, 1997, implements the requirements of the OMB Circular A-123 in developing effective management controls.

## **Internal Controls Over the Compilation and Reporting of Environmental Liabilities Data**

The Air Staff did not have adequate internal controls over the compilation and reporting of cost-to-complete estimates for environmental liabilities at active and BRAC installations. The control environment of Air Staff was weak because management did not assign the reporting of cost-to-complete estimates for environmental liabilities at the appropriate level of risk; promote training for personnel; or provide oversight of the environmental program. The four active installations visited did not maintain audit trails and documentation; and the personnel either lacked training, or did not retain training records, or both. Two of the three major commands visited lacked proper segregation of duties, and all three lacked adequate documentation of supervisory reviews. We identified deficiencies in the control activities at active installations and major commands that led to ineffective internal controls over the compilation process by Air Staff. BRAC installations had an isolated instance involving the lack of proper segregation of duties. The four BRAC installations we visited also did not maintain effective control activities such as timely supervisory reviews and adequate training.

### **Air Force Control Environment at Active Installations**

**Risk.** The Air Force established a weak control environment for managing and reporting cost-to-complete estimates for environmental liabilities. Management's philosophy and operating style affect the control environment. GAO standards indicate that positive and supportive attitudes towards internal controls and conscientious management create an effective control environment. Risk assessment as defined by GAO is the entity's identification and analysis of relevant risks to achieve its objectives, forming a basis for determining how the

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risks should be managed. In addition, GAO outlines several factors that affect the inherent risk, including the nature of the program and the nature of material transactions and accounts. Specific elements of these factors include audit difficulty, estimates that are based on management's judgment, and problems with realization and valuation.

Correspondence we received from the Chief of the Environmental Division, Air Staff, indicates that the Air Force considered the submission of data used to compile cost-to-complete estimates for environmental liabilities as low risk to the management of environmental programs. Despite the Air Force's assessment, DoD identified the reporting of environmental liabilities as a systemic management control weakness for FYs 2002, 2003, and 2004. Furthermore, the GAO has identified environmental liabilities as a high risk area for financial statement reporting. Recognizing and accepting the proper level of risk associated with reporting cost-to-complete estimates for environmental liabilities will reinforce the need for effective internal controls and help improve the control activities. Air Staff manages the environmental program; in addition, they review and approve the cost-to-complete estimates for environmental liabilities reported in the financial statements. Active installations prepare the cost-to-complete estimates, the major commands review and approve this information. (See Appendix E for an illustration of the environmental information flow process.) SAF/FM and Defense Finance and Accounting Service perform analytical reviews on the cost-to-complete environmental liability estimates reported in the Air Force and DoD-Wide financial statements. The path for compiling and reporting cost-to-complete estimates for environmental liability data into the financial statements leads from the installations up to the Air Staff. Data can easily be changed or eliminated anywhere along the path. Some data are not reported in the financial statements because program personnel judge that the data need not be included. Therefore, the flow of information through these levels is critical. Information reaching the SAF/FM and the Defense Finance and Accounting Service is rolled up and consolidated in Note 14 without further review of details.

**Training.** Air Staff did not commit to training the personnel compiling the environmental liability cost-to-complete estimates for inclusion in Note 14 of the annual financial statements because Air Staff did not consider this to be its responsibility. According to the Integration Branch Chief at Air Staff, the Environmental Division is responsible for issuing policy and guidance for the overall execution of the environmental program; however, the responsibility of ensuring the accuracy of the environmental data rests with SAF/FM. The Integration Branch Chief further stated that restoration program managers at the active installations and major commands need not excessively concern themselves with environmental liability issues, training, and confusing financial terminology because the financial community within the Air Force handles those issues.

Personnel at active installations and major commands annually prepare budget data for environmental costs for the upcoming execution year, which generally covers cost for 12 to 18 months from the time prepared. In addition, the personnel prepare the restoration liability submissions used by SAF/FM and the Defense Finance and Accounting Service to support Note 14 of the annual financial statements. For financial statement purposes, the cost-to-complete

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estimates for environmental costs support both the current and non-current liabilities. Because of the lack of training, the restoration program managers could not distinguish between the information prepared in support of the annual budget submission and the information prepared as support in the restoration liability submission used for the annual financial statements. In order to limit the confusion for the restoration managers, Integration Branch management encouraged active installations to use information to support multiple tasks; this included using the budget estimate submission to support the restoration liability submission which is reported in the annual financial statements.

Using the same data for both purposes created incomplete environmental data for the annual financial statements. During site visits, we observed that restoration program managers had access to the appropriate guidance for compiling the cost-to-complete estimates for financial reporting. However, they did not follow the guidance because they lacked necessary knowledge of financial terminology and financial reporting requirements to properly compile the environmental data. Air Staff management can contribute to fulfilling the internal control goal of reliable financial reporting when it takes steps to ensure that personnel are well trained on the value of compiling environmental data and the importance of financial reporting so that they understand how these tie into agency goals and objectives.

**Oversight.** Air Staff did not provide oversight of the environmental program to ensure that active installations properly compiled cost-to-complete data and that major commands reviewed and reported data accuracy. Air Staff assigned three branches to the environmental process. The Restoration Branch and the Quality Branch are responsible for the oversight and collection of data for DERP and non-DERP installations, respectively. The Restoration Branch is also responsible for conducting annual Program Management Reviews with the major commands to assess the effectiveness of their programs and to ensure that targets and goals are on track. The Integration Branch is responsible for approving DERP and non-DERP cost-to-complete data and the accompanying Note 14 narrative text for the financial statements.

The Restoration and Quality Branches send an annual data call to active installations and major commands for restoration liability submission. According to Air Force Instruction 32-7020, active installations prepare and maintain supporting documentation for environmental liability cost-to-complete estimates, however, the major commands are responsible for the accuracy of the environmental liability cost-to-complete estimates prepared by the active installations. We believe the way to ensure accuracy is through review and approval. Section 15.8.3 of the DERP Management Guidance requires each Component of the process to review its financial processes and data. In addition, section 15.8.3 requires a disclosure statement to address instances where the entity does not meet accounting standards. Non-DERP guidance had not been issued at the time of our review; however, in our opinion, the same requirements in the DERP Management Guidance should apply to non-DERP transactions. The Restoration and Quality Branches did not review the restoration liability reporting processes and data related to the cost-to-complete estimates prepared at the active installations and major commands to ensure that they submitted reliable information for cost-to-complete estimates for environmental liabilities. The two

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Branches assumed that active installations and major commands were preparing and maintaining information according to applicable guidance.

The Restoration and Quality Branches did not have a process in place to ensure that major commands reviewed and approved DERP and non-DERP environmental cost-to-complete data that supported the reported amounts. For example, two major commands were unaware that the active installations were not preparing and maintaining project documentation and RACER estimates for the DERP noncurrent portion of the reported environmental liability. Consequently, the Integration Branch approved DERP and non-DERP environmental liability cost-to-complete estimates data and narrative text for Note 14 without assurance that the information used was prepared and maintained consistent with DoD requirements. Effective oversight can help identify deficiencies and internal control vulnerabilities in various processes of program management.

## **Air Force Control Activities**

None of the active and BRAC installations we visited fully complied with internal control guidance when managing and compiling cost-to-complete estimates for environmental liabilities. The FMR and DERP Management Guidance both require that documentation to support audit trails be maintained and readily available for inspection at the time of audit. OMB Circular A-123 requires that key duties and responsibilities in authorizing, processing, recording, and reviewing official agency transactions be separated among individuals. Personnel involved in the preparation of DERP and non-DERP cost-to-complete estimates did not maintain evidence of supervisory reviews. The major commands and active and BRAC installations either lacked evidence of training or personnel were not trained. Two of the three major commands visited circumvented controls by managing cost-to-complete estimates for environmental projects on behalf of the active installations instead of requiring the active installations to prepare, implement, and maintain appropriate supporting documentation as outlined in Air Force Instructions. In another instance, BRAC installation personnel assumed multiple roles in reviewing and authorizing environmental data. Effective segregation of duties would reduce the risk of error or fraud. OMB Circular A-123 also encourages organizational policies and procedures that reasonably ensure that reliable and timely information is obtained, maintained, and reported. The four BRAC installations we visited did not conduct timely reviews of the environmental data used to support the annual financial statements. OMB Circular A-123 also requires management to commit to competence by requiring personnel to possess and maintain a level of proficiency to accomplish assigned duties.

**Audit Trails and Documentation.** Four DERP and three non-DERP installations visited did not maintain adequate audit trails and documentation to support the environmental liability cost-to-complete estimates.

**DERP.** Active Air Force installations did not maintain adequate audit trails to ensure that documentation was readily available to support the cost-to-

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complete estimates used for the DERP environmental liability. None of the active Air Force installations visited had sufficient documentation to support the total cost-to-complete estimates reported in AFRIMS. Three active installations did not provide project narratives, RACER estimates, or any other supporting documentation for noncurrent years (FY 2006 through completion) reported in the AFRIMS database. Project documentation in support of the current liability for one active installation was obtained from the major command. One active installation was unable to provide any documentation to support the FY 2004 submittals for the restoration liability because a computer crash caused the loss of RACER-generated cost-to-complete estimates. Another active installation did not maintain project folders to support the amount reported in AFRIMS. Therefore, active installations were noncompliant with the requirements set forth by the FMR, DERP Management Guidance, and Air Force Instruction 32-7020. Evaluating and assessing the uniformity and adequacy of audit trails and documentation between installations and major commands will positively impact documentation retention practices and the availability of supporting documentation for inspection and review.

**Non-DERP.** Active Air Force installations and major commands did not maintain adequate documentation to support the cost-to-complete estimates used to report the non-DERP environmental liability. Non-DERP installations did not maintain and have readily available the source and other supporting documentation used to develop the assumptions in the estimates generated by RACER. Non-DERP installations also did not consistently follow guidance from the Quality Branch, “Accounting for Resource Conservation and Recovery Act - Underground Storage Tank Closure and Post Closure Care Costs,” by reporting cost-to-complete estimates for two or more underground storage tanks on one RACER document. Consequently, non-DERP reporting installations did not meet the DERP Management Guidance requirements that organizations that prepare cost estimates must retain adequate documentation to identify data sources, the estimating method accreditation, and the rationale used.

**Segregation of Duties.** Active Air Force installations and major commands did not maintain adequate segregation of duties when preparing DERP cost-to-complete estimates for environmental liability. A major command overextended its role by preparing installation-level environmental site data in AFRIMS. Air Force Instruction 32-7020 states that installations are required to prepare, implement, and maintain in AFRIMS all information required to generate schedule and cost-to-complete reports for each site to take it to closure. In addition, installations are required to maintain RACER cost estimate records for each site with associated changes and their justifications. AFRIMS is designed with specific data entry fields that belong to either the installation or major command. This built-in internal control feature is designed to ensure proper segregation of duties between the installations and major commands. Active installations enter cost-to-complete estimates and supporting data for each environmental site into AFRIMS. Major commands allocate the budgeted funds within AFRIMS, allowing installations to obligate funds against each environmental site.

At one major command, the personnel controlled every aspect of the AFRIMS transactions. According to an active installation, the major command entered data

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into the installation's requirement field within AFRIMS. The major command directed the installation to update the installation's database with the major command's modified data. Another major command assumed the management responsibilities of environmental projects from the installation because the installation did not effectively manage the Installation Restoration Program (IRP). Major command personnel misused their authority by circumventing established controls to separate key preparation and review tasks between installations and major commands. As a result, active installations and major commands did not implement the standards set forth by OMB Circular A-123, which states that separation of duties and responsibilities must be maintained for initiating, authorizing, processing, recording, and reviewing transactions. Establishing effective segregation of duties will help ensure the reliability of information prepared and aid in the prevention of error and fraud.

**Supervisory Reviews.** None of the Air Force organizations reporting DERP and non-DERP consistently document supervisory reviews conducted by management for the cost-to-complete estimates included in Note 14 of the financial statements.

**DERP.** Active Air Force installations and major commands did not consistently document supervisory reviews performed by management for the cost-to-complete estimates. Multiple levels of review for DERP installations exist at active installations and major commands. Environmental cost-to-complete documentation prepared at an installation can go through three levels of review before submission to the major command and an additional two levels of review at the major command before data is submitted to the Restoration Branch. At one active installation three people were in the chain of command: the Restoration Section Chief, the Environmental Flight Chief, and the Deputy Base Civil Engineer, and each one was to review the cost-to-complete documentation. The documentation obtained showed the Deputy Base Civil Engineer as the only individual in the chain of command that reviewed the data submitted to the major command.

Section 15.8.2 of the DERP Management Guidance requires management to develop and implement a formal document tracking process to identify and track all changes. It further states management must retain documentation of management reviews. Program managers at the three major commands stated they performed reviews of the installations program documentation; however, they did not retain or could not readily provide documentation of the changes they required the installations to make based on their reviews. During FY 2004, two of the major commands reviewed and validated documentation supporting the cost-to-complete estimates entered for the AFRIMS FY 2005 budget execution year submission. Active installations did not prepare and major commands did not review supporting documentation for the AFRIMS FY 2006 and out-years submission. Fully documenting all levels of supervisory review of cost-to-complete estimates will contribute to maintaining adequate audit trails.

**Non-DERP.** Active Air Force installations and major commands did not adequately maintain evidence of installation managers' reviews of non-DERP cost-to-complete estimates. Air Force personnel, the submittal of estimates by e-mail throughout the chain of command constitutes an inherent form of supervisory review. However, e-mail does not provide adequate information as to

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the extent of the review. The volatility of e-mail does not allow for adequate retention in cases of personnel and position changes. In addition, some active installation personnel responsible for preparing cost-to-complete estimates submitted data by e-mail to the major command for review prior to installation management's review and approval. These active installations did not comply with the DERP Management Guidance, which requires the retention of evidence demonstrating management review.

**Management of Human Capital.** Air Force organizations reporting DERP and non-DERP environmental data did not have adequate internal controls over training of personnel involved in the cost-to-complete estimates for the environmental process.

**DERP.** Active Air Force installations and major commands did not maintain adequate documentation or ensure personnel involved in the preparation of DERP cost-to-complete estimates for environmental liabilities received regular training. Active Air Force installations provided outdated training records and, in some instances, could provide no training records at all for the personnel that prepared and developed cost-to-complete estimates for environmental liabilities. Active Air Force installations and major commands did not properly implement and enforce section 15.8.1 of the DERP Management Guidance, which requires that staff maintain evidence of completed training. For example, at one active installation the training records indicated that some personnel did receive initial RACER training a few years earlier, but did not complete refresher training. Providing RACER "refresher" training to personnel will ensure that the personnel can continue to use RACER software with its upgrades and changes. One major command did provide current training records for its personnel, but those records revealed that the majority of personnel did not fulfill the requirements for annual training during FY 2004. Section 15.8.1 of the DERP Management Guidance requires management to develop and implement formal training programs (such as introductory training and recurring "refresher" training) for staff engaged in the development of cost-to-complete estimates or preparation of environmental restoration liability reports.

**Non-DERP.** Active Air Force installations and major commands did not retain adequate evidence of the type and frequency of training for personnel involved in the process. Training records received from active installations and major commands demonstrate that personnel training requirements were not being met. Another active Air Force installation did not have any documentation demonstrating that the personnel involved in the process of reporting the cost-to-complete estimates completed any RACER training at all. Air Force Instruction 65-201 requires that each primary reporting element provide managers the appropriate training to enable the fulfillment of obligations. OMB Circular A-123 encourages management to commit to competence by requiring personnel to possess and maintain a level of proficiency to accomplish assigned duties. Management's commitment will emphasize the importance of developing and implementing effective internal controls.

**BRAC Reporting Organization.** BRAC installations are responsible for developing, reviewing, and validating the cost-to-complete environmental liability estimates. They are also required to prepare and maintain supporting

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documentation relating to future cleanup of contamination resulting from waste disposal methods, leaks, spills, and other past activities that have created public health and environmental risks. AFRPA reviews and consolidates the cost estimates from the BRAC installations and includes cost-to-complete estimates in the reported environmental liabilities on the annual financial statements.

**Segregation of Duties.** One of the four BRAC installations we visited did not maintain proper segregation of duties when reviewing the BRAC environmental data. OMB Circular A-123 states that the key duties and responsibilities in authorizing, processing, recording, and reviewing official agency transactions should be separated among individuals. Managers should exercise appropriate oversight to ensure individuals do not exceed or abuse their assigned authorities. AFRPA yearly instructions defined responsibilities for BRAC installations preparing environmental cost-to-complete data for inclusion in the FY 2004 Annual Financial Statements. The Base Environmental Coordinator (BEC) reviews the estimator's RACER-generated cost-to-complete estimates and the RACER input parameters and assumptions contained in the site-level documentation folders. The Site Manager reviews the overall cost-to-complete worksheets approved by the BEC. The BEC and Site Manager must sign a Quality Assurance Checklist, which attests to their review of the environmental liability cost-to-complete estimate documentation. At this BRAC installation, the BEC assumed responsibilities of the Site Manager, which compromised adequate segregation of duties.

**Supervisory Reviews.** BRAC installations did not perform timely reviews of the cost-to-complete estimates used to support environmental liabilities. According to OMB Circular A-123, management controls are the organization's policies and procedures used to reasonably ensure that reliable and timely information is obtained for decision making. Cost-to-complete guidance issued by AFRPA on July 27, 2004, did not stipulate the timeframe and deadline when installation management should perform the reviews. Therefore, personnel involved in the review process at the BRAC installations conducted their reviews of the cost-to-complete estimates 2 to 4 months after the actual September 30, 2004, submittal deadline. BRAC installations lacked resources to properly implement the requirements of OMB Circular A-123. Defining time requirements for supervisory review will help ensure accuracy of financial data included in the annual financial statements.

**Management of Human Capital.** BRAC installations did not retain evidence or ensure proper training of the personnel involved in the preparation and reporting of BRAC environmental cost-to complete estimates. The DERP Management Guidance requires Components to develop and implement a formal training program for staff engaged in the development of cost-to-complete estimates or preparation of environmental restoration liability reports. In addition, documentation that staff received the training must be maintained as support for the audit of the annual financial statements. At all BRAC installations we visited the supervisory staff involved in the preparation of environmental liability reports did not have current training and, in some cases, training records were unavailable for review. Available training records of the staff involved in the preparation of cost-to-complete estimates revealed that personnel did not have refresher training for RACER or any type of training during FY 2004.

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Establishing training requirements for personnel involved in the preparation of environmental liability information could provide assurance that personnel are knowledgeable of reporting requirements and updates to system used to manage data.

## **Compliance with Environmental Liabilities Guidance and Regulations**

Active installations, major commands, and BRAC installations visited did not provide reasonable assurance that DERP Management Guidance and applicable Air Force guidance concerning internal controls would be followed. In addition, non-DERP managers lacked specific implementation guidance. As a result, the Air Force had a weak control environment and control activities.

**DERP Management Guidance.** Active and BRAC installations did not fully or consistently comply with DERP Management Guidance. DUSD (I&E) developed the DERP Management Guidance to outline the requirements of the program for all DoD Components. The Air Force DERP and BRAC installations are responsible for implementing the DERP Management Guidance within their respective activities.

Air Staff created, "Management Guidance for the United States Air Force Environmental Restoration Program," for use by DERP and BRAC installations reporting cost-to-complete estimates for environmental liabilities. The major commands involved in the DERP activities developed specific handbooks and other guidance for use by active installations. The handbooks and additional guidance provided instructions on the implementation of the IRP. Air Staff and major commands properly incorporated the requirements of the DERP Management Guidance; however, the guidance does not provide detailed instructions on how to implement the requirements of the DERP Management Guidance for supervisory reviews, training, and audit trails and documentation. Furthermore, the guidance provided by Air Staff and major commands did not specify the types, extent, and level of documentation that would constitute an adequate audit trail for the total amount reported for environmental liabilities cost-to-complete estimates. The guidance also did not specify the appropriate types of evidence to demonstrate effective internal controls such as segregation of duties, supervisory review, and management of human capital. Because Air Staff did not provide detailed instructions, installations were unable to produce adequate audit trails and documentation.

AFRPA properly ensured that BRAC installations retained adequate audit trails and cost-to-complete estimates. However, AFRPA did not properly implement DERP Management Guidance training requirements.

**Air Force Guidance.** Active installations did not fully comply with applicable Air Force guidance. Air Force Instruction 65-201, "Management Control," May 1, 1997, requires each primary reporting element to provide managers the appropriate training to enable the fulfillment of obligations. Active installations could not demonstrate through training records that personnel received

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appropriate training and maintained the level of competence to perform tasks. Lack of training could lead to possible errors in cost-to-complete estimating for the amounts reported in support of environmental liabilities.

**Non-DERP Guidance.** DUSD (I&E) did not develop guidance for the management and reporting of non-DERP environmental liabilities cost-to-complete estimates. However, Quality Branch did provide specific instructions to non-DERP installations for use in the preparation of cost-to-complete estimates for environmental liability information. Despite these specific instructions, non-DERP installations could not provide adequate audit trails and documentation, supervisory reviews, and management of human capital. As of June 2005, DUSD (I&E) issued draft non-DERP guidance to DoD Components for comment.

## Reliability of Reporting Cost-to-Complete Estimates

Air Force did not establish a restoration liability reporting process for DERP and may have reported erroneous cost-to-complete estimates for environmental liabilities in FY 2004. Active installations and major commands did not have an identifiable process for the preparation, review, and submittal of DERP cost-to-complete estimates for environmental liability data used to support the annual financial statements. Existing evidence for project narratives, RACER estimates, and other supporting documentation (prepared by the active installations and reviewed by the major commands) supported the FY 2005 Annual Budget Estimate Submission to Congress. Establishing a separate process exclusively for preparing and reviewing data used to report cost-to-complete estimates for restoration liability reporting would help ensure that financial reporting goals are maintained through effective internal controls. The major commands submitted data to the Restoration Branch for the restoration liability submission without adequately reviewing documentation at the installations.

Section 15.5 of the, “DERP Management Guidance,” states that Component- and Departmental-level cost-to-complete estimates and the values in the financial statements for environmental restoration must be consistent with each other and able to withstand an audit. The DERP reporting installations treated the data submitted to Air Staff, in support of the restoration liability reporting submission on September 17, like a regular AFRIMS download, which is done nine times a year. For example, at two active installations RACER-generated cost-to-complete estimates and project narratives supported projects scheduled for the FY 2005 budget execution year. Active Air Force installations entered unsupported cost-to-complete data in AFRIMS that reflected the entire restoration cost for an environmentally hazardous site. Active installation personnel claimed that the amounts in AFRIMS for the out years (or noncurrent portion of the environmental liability) are based on similar restoration activities conducted in the past or on undocumented professional knowledge. An identifiable restoration liability reporting process could help prevent the control activity weaknesses identified in this report, and therefore reduce potential environmental liability misstatement.

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## Conclusion

The Air Force needs to improve internal controls over reporting cost-to-complete estimates for environmental liabilities by strengthening its control environment and control activities. An ineffective control environment can negatively affect an entity's integrity, operating style, structure, and its relationship with Congress and central oversight agencies. Deficiencies in the control activities can affect an entity's planning, implementing, reviewing, and accountability for stewardship of Government resources and achieving effective results. To improve the extensive weaknesses and deficiencies we identified, Air Force Management should take steps to improve internal controls over reporting cost-to-complete estimates for environmental liabilities.

## Recommendations

A.1. We recommend that the Director, Air Force Office of the Civil Engineer, Environmental Division:

a. Improve its control environment by:

(1) Treating all portions of the environmental liability data reporting process as high risk and developing standards to establish data integrity at all levels of reporting within the Environmental Division.

(2) Developing and providing training to employees responsible for reporting environmental liability cost-to-complete estimates for inclusion in the annual financial statements. The training should include the purpose of financial reporting and define agency requirements for producing and maintaining auditable documentation in accordance with applicable Federal laws and DoD regulations.

(3) Providing oversight throughout the organization to ensure that proper operating activities and reporting relationships exist.

b. Direct major commands and active installations to improve control activities by:

(1) Establishing a process to evaluate and assess the uniformity and adequacy of audit trails and documentation, segregation of duties, and supervisory review at active installations and major commands. This process should define and enforce the requirements of Office of Management and Budget Circular A-123 and other applicable guidance to ensure effective internal controls.

(2) Establishing additional guidance for active installations and major commands that defines training requirements according to the Defense Environmental Restoration Program Management Guidance and other applicable guidance.

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(3) Establishing a process for active installations and major commands to follow during the preparation and compilation of cost-to-complete estimates used for restoration liability reporting submission.

A.2. We recommend that the Director, Air Force Real Property Agency:

a. Establish a process to ensure that no one person at Base Realignment And Closure installations performs more than one of the key duties and responsibilities in authorizing, processing, recording, and reviewing cost-to-complete estimates.

b. Establish time requirements for Base Realignment and Closure installations to perform supervisory review of cost-to-complete estimates for environmental liability data reported in the fiscal year financial statements.

c. Establish additional guidance for Base Realignment and Closure installations to define training requirements according to the Defense Environment Restoration Program Management Guidance and other applicable guidance.

## **Management Comments Required**

Comments on the draft report were received from the Assistant Secretary of the Air Force (Financial Management and Comptroller) too late to be incorporated into the final report. Therefore, if the Assistant Secretary does not submit additional comments, we will consider those comments as the management response to the final report.

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## **B. Air Force Office of the Civil Engineer Environmental Division Management Control Program for Environmental Liabilities**

The Air Staff management control program was ineffective and did not identify material weaknesses related to compiling and reporting cost-to-complete estimates for environmental liabilities in the annual financial statements. This occurred because Air Staff did not perform a general assessment of the internal controls for the compilation of cost-to-complete estimates for environmental liabilities. As a result, controls were not adequate to ensure that cost-to-complete estimates used for environmental liability were accurate.

### **Criteria for Management Control Programs**

**Government Accountability Office.** GAO/AIMD-00-21.3.1, “Standards for Internal Control in Federal Government,” November 1999, states,

The Federal Managers’ Financial Integrity Act of 1982 requires the Government Accountability Office to issue standards for internal control in government. The standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

The five standards for internal control are: control environment, risk assessment, control activities, information and communications, and monitoring. These standards define the minimum level of quality acceptable for internal control in government and provide the basis against which internal control is to be evaluated.

**DoD Directive.** DoD Directive 5010.38, “Management Control Program,” August 26, 1996, implements the GAO and OMB guidance that is required by the Federal Managers’ Financial Integrity Act of 1982. The DoD Directive requires DoD Components to implement a comprehensive strategy for management controls that provides reasonable assurance that “... programs and administrative and operating functions are efficiently and effectively carried out in accordance with applicable law and management policy.” The management control process should be integrated into the daily management practices of all DoD managers. When developing the Management Control Program, DoD managers should rely on all contributing information sources, including external audits.

**DoD Instruction.** DoD Instruction 5010.40, “Management Control Program Procedures,” August 28, 1996, requires DoD Components to develop a Management Control Program. The Management Control Program, through its

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self assessment process, assists managers in identifying material management control weaknesses. The DoD Instruction states that in order for a weakness to be material, two conditions must be satisfied:

- management controls are not in place, not used, or not adequate, and
- the weakness is material enough to require the attention of the next level of management.

Each DoD Component should submit an annual statement of assurance based on a general assessment of the effectiveness of the management controls.

## **Assessment of Internal Controls**

The Air Staff management control program was ineffective and did not identify material weaknesses related to the compiling and reporting of cost-to-complete estimates for environmental liability data in the annual financial statements. Air Staff did not perform a general assessment of the internal controls over the compiling and reporting cost-to-complete estimates for environmental liabilities.

These deficiencies occurred because Air Staff did not collect, review, or consolidate documentation of management control programs from major commands. Periodic assessments of internal controls would reveal inadequate and ineffective control practices and identify opportunities for improvement. Air Staff did not provide input for the overall FY 2004 Annual Statement of Assurance. As a result, the adequacy of management controls over cost-to-complete estimates for environmental liabilities was not properly represented in the FY 2004 Annual Statement of Assurance.

## **Recommendation**

B. We recommend that the Chief, Air Force Office of the Civil Engineer, Environmental Division:

a. Perform periodic assessments of the internal controls identified by the major commands' management control programs to determine effectiveness and reliability of internal controls.

b. Report the material weaknesses identified in finding A of this report and other material weaknesses identified through assessments in its annual statement of assurance until corrected.

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## **Management Comments Required**

Comments on the draft report were received from the Assistant Secretary of the Air Force (Financial Management and Comptroller) too late to be incorporated into the final report. Therefore, if the Assistant Secretary does not submit additional comments, we will consider those comments as the management response to the final report.

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## Appendix A. Scope and Methodology

We reviewed the Air Force processes and data used for compiling and reporting cost-to-complete estimates for environmental liabilities used in Note 14 of the Air Force FY 2004 Annual Financial Statements. We reviewed the control environment and control activities over \$7.4 billion of Air Force cost-to-complete estimates for environmental liabilities reported on Note 14. The Air Force reports DERP, non-DERP, and BRAC cost-to-complete estimates for environmental liabilities from 227 active and 28 BRAC installations in the United States.

**Active Installations.** We visited the following Commands: Air Force Materiel Command, Air Mobility Command, and Air Education and Training Command. We visited Edwards Air Force Base, which reports to the Air Force Materiel Command; Scott and McChord Air Force Bases, which report to the Air Mobility Command; and Lackland Air Force Base, which reports to the Air Education and Training Command. We reviewed DERP and non-DERP transactions to gain an understanding of the internal controls used at these installations.

Active Air Force installations reporting DERP environmental liability activities showed a total of 4,392 cost-to-complete estimates as of September 30, 2004. We selected a judgmental sample and reviewed 65 transactions for the four installations visited. This represented different phases of the Environmental Restoration Process and highest and lowest dollar amounts.

Active Air Force installations reporting non-DERP environmental liability activities showed 2,394 transactions as of September 30, 2004. We selected a judgmental sample and reviewed 15 transactions that represented different phases of the Environmental Restoration Process and highest and lowest dollar amounts.

**BRAC Installations.** We visited McClellan Air Force Base, which is the regional operating location for McClellan, March, and Norton Air Force Bases, and Loring Air Force Base, which also manages Pease Air Force Base. At all locations we reviewed cost-to-complete estimates for the installations to gain an understanding of the internal controls.

BRAC Air Force installations reporting BRAC environmental liability activities showed 1,554 transactions as of September 30, 2004. We selected a judgmental sample of 28 transactions that represented different phases of the Environmental Restoration Process and highest and lowest dollar amounts.

We performed this audit from November 2004 through August 2005 in accordance with generally accepted government auditing standards. Controls reviewed included development of estimates, personnel qualifications and training of estimators, supervisory reviews of estimates, and audit trails and documentation supporting estimates.

We did not review Department of the Army or Department of the Navy internal controls for reporting environmental liabilities. The Army is implementing corrective actions from DoD OIG Report Number D-2004-080, and the Naval

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Audit Service is currently conducting agreed-upon procedures for the Department of the Navy.

To accomplish this audit, we requested Air Staff and AFRPA to provide the audit team with the appropriate environmental liability databases for active and BRAC installations. We identified, analyzed, and evaluated the cost-to-complete estimates from the databases using applicable requirements contained in OMB Circular A-123, DoD FMR, DoD and Air Force DERP guidance, and Air Force instructions.

**Use of Computer-Processed Data.** To achieve the audit objectives, we relied on computer-processed data retrieved from the Air Staff AFRIMS database, non-DERP Microsoft Excel Spreadsheets, the AFRPA MIS, and RACER in support of the estimated environmental liability reported in the Annual Financial Statement. Although we did not perform a formal reliability assessment of the computer-processed data, the reliability of the computer-processed data had no effect on the audit because we focused on the process associated with compiling the data. We used the data to validate whether the costs are reasonably determined, approved, and documented.

**Government Accountability Office High-Risk Area.** The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Financial Management high-risk area.

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## **Appendix B. Prior Coverage**

The Government Accountability Office (GAO), the Department of Defense Inspector General (DoD IG), and the Air Force Audit Agency (AFAA) have issued 20 reports during the last 5 years that discuss environmental liabilities. Unrestricted GAO and DoD IG reports can be accessed over the Internet at <http://www.gao.gov> and <http://www/dodig.mil/audit/reports>, respectively.

### **GAO**

GAO Report No. GAO-03-98, "Major Management Challenges and Program Risks," January 2003

GAO Report No. GAO-02-117, "Environmental Liabilities – Cleanup Costs from Certain DoD Operations Are Not Being Reported," December 2001

GAO Report No. GAO-01-479, "Environmental Liabilities: DoD Training Range Cleanup Costs Estimates Are Likely Understated," April 2001

### **DoD IG**

DoD IG Report No. D-2005-017, "Independent Auditor's Report on the FY 2004 DoD Agency-Wide Financial Statement," November 12, 2004

DoD IG Report No. D-2004-080, "Environmental Liabilities Required To Be Reported On Annual Financial Statements," May 5, 2004

DoD IG Report No. D-2004-036, "Independent Auditor's Report on the FY 2003 DoD Agency-Wide Financial Statements," December 10, 2003

DoD IG Report No. D-2003-0050, "Independent Auditor's Report on the Department of Defense Fiscal Year 2002 Agency-Wide Principal Financial Statements," January 15, 2003

DoD IG Report No. D-2001-172, "Data Supporting the Environment Liability Reported on the FY 2000 Financial Statements," August 10, 2001

DoD IG Report No. D-2000-168, "Data Supporting the Environmental Liability Line Item on the FY 1999 DoD Financial Statement," July 27, 2000

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## **Air Force**

AFAA Report No. F2003-0006-FB4000, "Follow-up Audit – Restoration Contingent Liabilities at Closed Installations," February 28, 2003

AFAA Report No. F2002-0005-B05300, "Accounting for Air Force Liabilities, Fiscal Year 2001," July 29, 2002

AFAA Report No. F2002-0005-B05200, "Follow-up Audit-Installation Support of the Environmental Restoration Program," April 23, 2002

AFAA Report No. F2002-0002-B05200, "Environmental Compliance Cleanup Liabilities," March 8, 2002

AFAA Report No. 0005406, "Air Force Information Management System Controls," May 18, 2001

AFAA Report No. 00052012, "Environmental Restoration Contingent Liabilities at Closed Installations," February 27, 2001

## Appendix C. Effective Internal Control Practices

<b>Examples of an Effective Control Environment and Control Activities</b>	
<b>CONTROL ENVIRONMENT</b>	
<b>Philosophy and Operating Style</b>	Management establishes a positive attitude towards information systems, accounting, personnel functions, monitoring, and audits and evaluations.
<b>Commitment to Competence</b>	Management identifies appropriate knowledge and skills needed for various jobs and provides needed training, ensuring that personnel possess and maintain a level of competence to accomplish assigned duties.
<b>Organizational Structure</b>	Agency's structure clearly defines areas of responsibility and lines of reporting.
<b>Delegation of Authority and Responsibility</b>	Management appropriately delegates authority for operating activities, reporting relationships, and authorization protocols.
<b>CONTROL ACTIVITIES</b>	
<b>Appropriate Documentation of Transactions and Internal Control</b>	Personnel clearly document internal controls, transactions, and other significant events and ensure documentation is readily available for examination.
<b>Segregation of Duties</b>	Agency divides or segregates key duties and responsibilities among several individuals to reduce the risk of error or fraud.
<b>Reviews by Management at the Functional or Activity Level</b>	Managers compare actual performance to planned or expected results throughout the organization and analyze significant differences.
<b>Management of Human Capital</b>	Entities effectively manage human capital by ensuring that qualified personnel performing tasks receive adequate training, tools, structure, incentives, and responsibilities.
<b>FINANCIAL REPORTING</b>	
An effective internal control process includes steps to mitigate external factors such as human mistakes, judgment errors, and acts of collusion to circumvent controls. Once in place, internal controls provide reasonable assurance of meeting agency objectives, which includes the reliability of financial reporting.	

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## **Appendix D. Other Matters of Interest**

### **Military Munitions Response Program**

MMRP includes response actions to address military munitions or the chemical residues of munitions. MMRP projects will receive initial funding during FY 2005. MMRP is in its infancy, and there is not a concrete basis for the environmental estimates planned for future projects. Therefore, the total reported liability will likely increase significantly after completing investigations of potential sites near the end of FY 2007. The reported environmental liability for DERP installations in the FY 2004 Annual Financial Statements properly included the estimated costs for MMRP activities scheduled for FY 2005 and beyond.

### **Information Management System**

The data and processes used to report non-DERP environmental liabilities in the Air Force financial statements lacked effective access controls and adequate edit checks. Air Force active installations generated RACER estimates or used historical documents to produce cost-to-complete estimates. However, the Air Force active installations and major commands could not ensure the proper execution of transactions and events, or the existence of system audit trails to ensure the reliability of data. This occurred because the non-DERP program did not have an information management or financial management system in place to process and maintain cost-to-complete information for non-DERP environmental liabilities. Instead, non-DERP reporting installations use Microsoft Excel spreadsheets to compile and track environmental liability data. As a result, the non-DERP cost-to-complete information was potentially at risk for manipulation, thus affecting the validity and reliability of the cost-to-complete estimates used in support of environmental liabilities by the Air Force active installations.

The Air Force is currently developing a management information system that will have the capability to manage both DERP and non-DERP environmental liabilities. Until the system is in place, non-DERP installations should develop mitigating controls to ensure the integrity of data compilation and submittals to major commands and Air Staff for inclusion in the Air Force annual financial statements.

### **Quarterly Reporting**

Active and BRAC Air Force installations do not report new cost-to-complete estimates on a quarterly basis. Installations report cost-to-complete estimates for sites identified as environmental hazards at the end of each fiscal year. Monthly submittals to the Defense Financial Accounting Service include Air Force liability expenditures against previously reported obligations. In the event of new site identifications for cleanup during the fiscal year, installation personnel should prepare cost-to-complete estimates for the new site and report to Defense Financial Accounting Service in the quarter that a reasonable estimate can be developed.

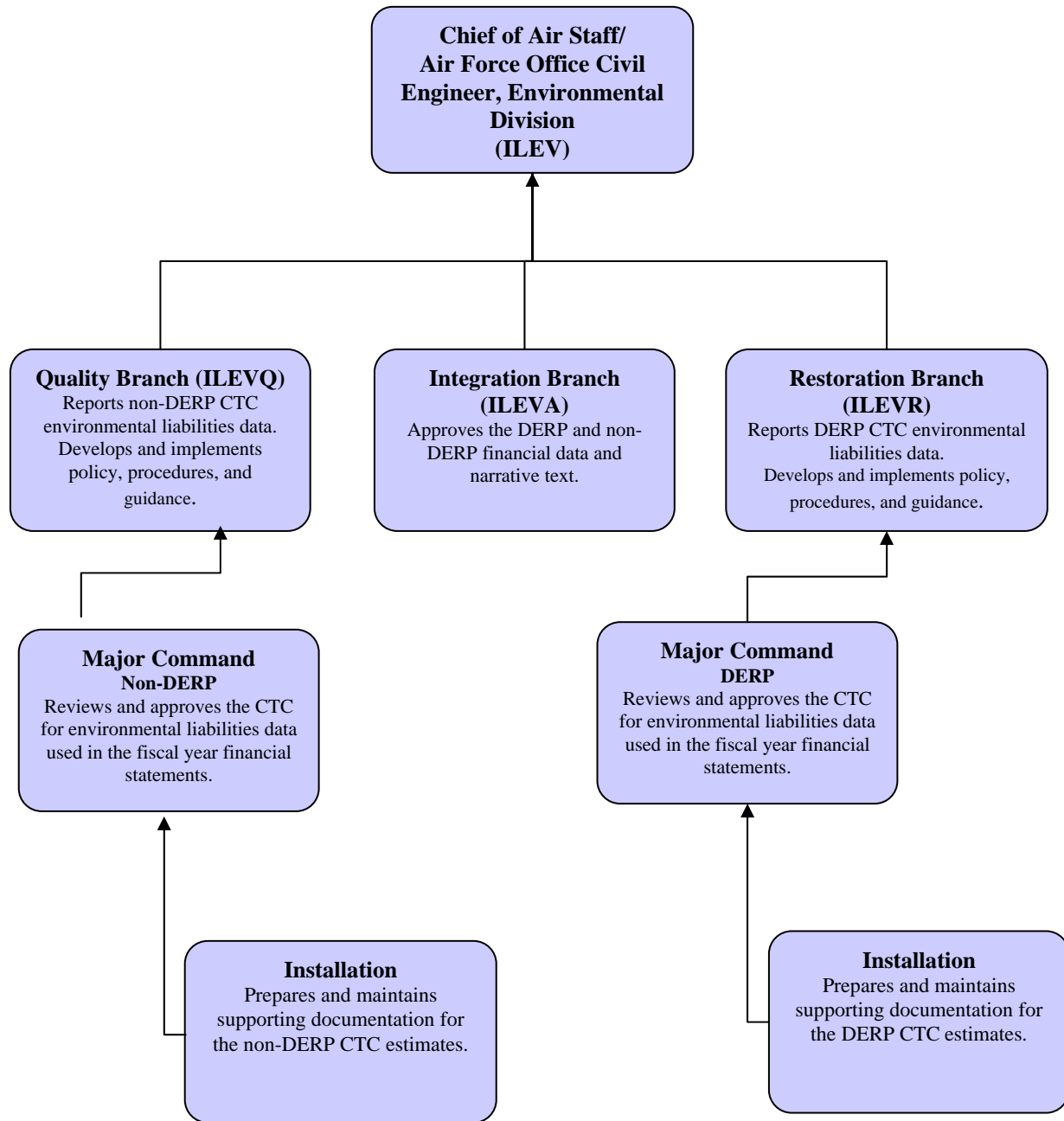
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Air Force management believes that because of the constant changing of cost-to-complete estimates throughout the year, reporting their value in the financial statements quarterly would not accurately represent the true environmental liability. Until there is further guidance from the DoD financial and policy communities, the Air Force should disclose in Note 14 of the Air Force financial statements that the reporting period for cost estimates is once every fiscal year and that only expenditures are reported quarterly to Defense Financial Accounting Service.

## **Corrective Actions taken by the Air Force Real Property Agency**

The AFRPA provided DoD OIG a copy of the proposed FY 2005 cost-to-complete data submission guidance. The guidance clarifies review and signature requirements for the Supervisory Review and Quality Assurance checklists. The FY 2004 cost-to-complete data submission guidance required the signatures of the BEC and the Site Manager on both checklists. The proposed FY 2005 guidance requires the estimator or engineer to sign the Supervisory Review checklist as the preparer and the BEC as the reviewer of the estimate. The Quality Assurance checklist requires the BEC to sign as reviewer and the Site Manager as approver of the estimate. This new guidance will further define segregation of duties for preparing and submitting cost-to-complete data.

# Appendix E. Environmental Information Flow Process as Designed



Legend:

→ Flow of Information

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## **Appendix F. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition, Technology, and Logistics  
Director, Acquisition Resources and Analysis  
Under Secretary of Defense (Comptroller)/Chief Financial Officer  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Under Secretary of Defense (Installations and Environment)

### **Department of the Army**

Auditor General, Department of the Army

### **Department of the Navy**

Naval Inspector General  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Auditor General, Department of the Air Force  
Deputy, Air Force Civil Engineer for Installation, Logistics, and Engineering

### **Other Defense Organizations**

Director, Defense Finance and Accounting Service  
Director, Air Force Civil Engineer  
Director, Air Force Real Property Agency

### **Non-Defense Federal Organization**

Office of Management and Budget  
Government Accountability Office

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## **Congressional Committees and Subcommittees, Chairman and Ranking Minority Member**

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
House Committee on Armed Services  
House Committee on Government Reform  
House Subcommittee on Government Management, Finance, and Accountability,  
Committee on Government Reform  
House Subcommittee on National Security, Emerging Threats, and International  
Relations, Committee on Government Reform

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