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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON REGIONAL OFFICE
FIFTH FLOOR
803 WEST BROAD STREET
FALLS CHURCH, VIRGINIA 22046

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Mr. Harry Osolin, Chief
Finance Division
Veterans Canteen Service
Veterans Administration
Washington, D.C. 20420

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Dear Mr. Osolin

As you know, we have completed our audit of the Veterans Canteen Service's (VCS) fiscal year 1973 financial statements and our report to the Congress is in preparation. We thought it would be useful to summarize for you certain matters which will not be included in our report but which we feel offer opportunity for improvements in the financial management area. These matters have been discussed with you and other VCS officials, and comments received have been included as appropriate.

Revised Accounting Procedures for
Contract Income Will Improve
Financial Statement Presentation

VCS receives substantial commission income from automatic food and beverage sales. A memo entry is kept of contractor sales of these items, and for statement purposes VCS includes these with regular VCS sales. The difference between contractor sales and commissions received is included as cost of sales. This practice overstates both sales and cost of sales. In fiscal year 1973, food department sales of \$27 million included \$9 million from automatic food and beverage operations. Although we could not readily determine the approximate portion, we were informed that a substantial part of the \$9 million would be contractor sales.

The General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies, title 2, subsection 15.1, states that "Revenues represent the increase in assets (or decrease in liabilities) which results from operations." You might be interested in knowing that the American Institute of Certified Public Accountants' position is that revenue be conventionally recorded at the amount received or expected to be received. Contract sales do not increase VCS assets by the total amount of the sales nor does VCS receive the total amount.

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You stated that contractor sales are included with VCS sales in the income statement in order to present the total sales volume of VCS and VCS-controlled activities. While we believe that visibility of contract sales and cost of sales is a valuable tool for internal management analysis, we suggest that sales of only those items to which VCS takes title be included in the income statement as VCS sales and that commission income be included as other operating income. We were informed that, with proper instructions to the field offices and canteens, segregation of actual sales and commission income could be accomplished without undue difficulty.

Deducting Purchase Discounts From Purchases
Provides More Accurate Cost of Sales

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In our letter to the Director on January 3, 1973, we suggested that purchase discounts be shown on the financial statements as a deduction from purchases, rather than as other income which had been VCS practice. We pointed out that this would provide management with the net cost of purchases and a better presentation of cost of goods sold. VCS's reaction was that the suggested method is not a uniform practice and, unless we have strong feelings about it, you would prefer to continue to show discounts as other income.

We recognize that some retail chain organizations consider purchase discounts as other income. We believe, however, that treatment of the discounts as a deduction from purchases provides a more accurate reflection of actual operating results. In fiscal year 1973, the inclusion of purchase discounts of \$370,000 as other income rather than as a reduction of cost of sales resulted in a 14 percent understatement of gross income, a 7 percent understatement of total operating income and a 20 percent understatement of net operating income.

The Comptroller General's position on this matter is stated in title 2 of the GAO Policy and Procedures Manual for Guidance of Federal Agencies, subsection 12 5(d)

In determining cost of purchased property, discounts shall be deducted from the prices billed. Such discounts are reductions of costs, representing savings achieved through payments of bills within the vendors' stipulated time limits. They are not income and shall not be accounted for as such, since they do not produce an increase in assets based on the sale of goods or the performance of services.

In view of the above, you might want to give further consideration to presenting purchase discounts as a reduction from purchases rather than as other income.

Capitalization of Leasehold Improvements Would
More Accurately Reflect Actual Expenses

Under generally accepted accounting principles, leasehold improvements are amortized over the expected length of occupancy or the life of the improvement, whichever is shorter. We found that it has been VCS's practice to expense rather than capitalize remodeling costs which are essentially leasehold improvements.

Although we did not determine the overall impact on VCS financial statements, approximately \$14,500 in remodeling expense was charged to current operations in fiscal year 1973 at three canteens in the San Francisco Field Office. This is equal to about 34 percent of that Field Office's operating income.

We were informed that remodeling costs have never been capitalized because VCS does not own canteen space and is subject to being moved at the discretion of the Veterans Administration. While we recognize that a canteen may be forced to move before remodeling costs are completely amortized, accepted accounting procedures provide that in such cases the unamortized balance is written off as an extraordinary loss.

Expensing of these items results in charging current operations with costs which can reasonably be expected to benefit future periods and can result in a distortion of income from year to year. We, therefore, suggest that VCS Operating Procedures be revised to require capitalization of remodeling costs.

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We also noted during our review that periodic physical inventories of fixed assets were not required at the Central Office or the field offices, although biannual inventories are required for canteens. No recent inventory had been taken at the Central Office. We understand that you plan to issue a directive requiring biannual inventories of fixed assets at the Central Office and field offices.

We would appreciate receiving your views and comments on the matters discussed in this letter and advice on any action taken or planned. A copy of the letter is being submitted to Mr. Bucknell.

We are ready to meet with you for further discussion if this will be helpful. We appreciate the courtesies and excellent cooperation extended our staff during this review.

Sincerely,

H. L. Krieger

H. L. Krieger
Regional Manager

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December 12, 1973

Mr. R. H. Bucknell, Director
Veterans Canteen Service
Veterans Administration
Washington, D.C. 20420

Dear Mr. Bucknell.

Enclosed for your information is a copy of our management letter to the Chief of the Finance Division. The letter contains several suggestions which we believe offer opportunity for improvements in VCS financial management.

We appreciate the courtesies and cooperation provided our staff again this year.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "H. L. Krieger".

H. L. Krieger
Regional Manager

Enclosure

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