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Report to the Acting Administrator, General Services Administration

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INTERNAL CONTROLS

Areas for GSA Management to Strengthen

GAO/AFMD-89-36

GAO

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Accounting and Financial
Management Division

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Mr. Richard G. Austin
Acting Administrator
General Services Administration

Dear Mr. Austin:

Our report, GAO/AFMD-89-17, dated November 21, 1988, presented the results of our audit of the General Services Administration's (GSA) financial statements for the fiscal year ended September 30, 1987. The report included internal accounting control weaknesses we identified that were, in our judgment, material in relation to GSA's consolidated financial statements taken as a whole. This report describes other opportunities for improving internal accounting controls and procedures which, although not material to GSA's consolidated financial statements, nonetheless warrant your attention. The report also discusses opportunities for improving GSA's financial management practices.

The objective of our audit was to report on the fair presentation of GSA's fiscal year 1987 consolidated financial statements. In conducting the audit, we made a study and evaluation of GSA's system of internal accounting controls to determine the nature, timing, and extent of auditing procedures necessary for expressing an opinion on GSA's consolidated financial statements. The opportunities for improving GSA's internal accounting controls, procedures, and financial management practices were identified during the examination of internal controls and through other phases of the audit. Our examination involved work at GSA's Washington, D.C., headquarters; regional offices in Washington, D.C.; San Francisco, California; Fort Worth, Texas; Kansas City, Missouri; New York, New York; and Philadelphia, Pennsylvania; and various stockpile and supply storage locations throughout the United States. The work at these locations encompassed all of GSA's major service and financial operations. Our audit work was conducted from April 1986 to March 1988 and in accordance with generally accepted government auditing standards.

GSA management is responsible for establishing and maintaining a system of internal controls in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982. The Financial Integrity Act requires managers to annually report any material internal control and accounting system weaknesses, along with planned corrective actions. While our evaluation was targeted at those internal controls related to the fairness of the financial statements, the Financial Integrity Act has a broader application. The act covers all management controls, not just those dealing with accounting controls and financial reporting, but the entire network of policies, procedures, practices, and systems that managers use to do their jobs. Therefore, we believe that the matters discussed in this report should be considered for inclusion in GSA's annual Financial Integrity Act report.

During fiscal year 1987, GSA substantially corrected the two material internal control weaknesses that we previously reported to the Congress after our examination of GSA's fiscal year 1986 consolidated financial statements (GAO/AFMD-87-49). GSA improved its controls and procedures in reconciling its cash balances with Treasury, although some minor problems related to this issue are noted in this report. GSA also made substantial progress in correcting problems in its fleet management operations accounting system which prevented the production of reliable data on accruals, depreciation, inventory, and accounts receivable through January 1987. However, our fiscal year 1987 audit (GAO/AFMD-89-17) disclosed a material weakness in internal accounting controls due to inaccuracies in GSA's inventory records for motor vehicles. The report also identified a material weakness in GSA's inability to properly account for revenue in the ADP Fund. GSA has acknowledged these weaknesses and is working to correct them.

Other Opportunities for Improving Internal Accounting Controls and Procedures

Our report entitled Internal Controls: System Problems Affecting GSA's Financial Reporting (GAO/AFMD-88-2), dated February 4, 1988), contained the less significant problems in internal accounting controls and procedures identified during our audit of GSA's fiscal year 1986 financial statements. The problems continuing from fiscal year 1986 and the additional ones we identified in fiscal year 1987 are summarized below. Appendix I contains detailed discussions of these items. Improvements are needed in these areas to prevent errors or irregularities that may affect the integrity of amounts reported in GSA's consolidated financial statements or lead to a misuse of assets.

- GSA's inventory surveillance teams did not perform the number of test counts GSA procedures require to ensure the accuracy of the general supply perpetual inventory records. This problem was also identified during our fiscal year 1986 audit. (See item 11.)
- GSA did not maintain adequate supporting documentation for some transactions, especially those concerning the Federal Buildings, Automated Data Processing, and Federal Telecommunications funds. This

problem was also identified during our fiscal year 1986 audit. (See items 4, 15, and 17.)

- Financial transactions were not always recorded in the proper fiscal year. For example, Federal Buildings Fund revenue had to be reduced by $2.6 million to reflect the effects of chargebacks on rent billings not recorded in fiscal year 1987. Additionally, adjustments totaling over $29 million were required to increase assets and liabilities of the General Supply Fund for transactions not recorded in fiscal year 1987. We encountered similar problems during our fiscal year 1986 audit. (See items 2 and 13.)
- Accounting principles were not always properly or consistently applied. For example, the established policy for capitalizing repair and alteration projects in the Federal Buildings Fund was not consistently followed. In addition, cash, equity, and income in the receipt funds were not properly accounted for in GSA's accounting records. These problems were also identified during our fiscal year 1986 audit. (See items 5 and 18.)
- Errors occurred in the computation of future lease obligations and were not detected. GSA's National Electronic Accounting and Reporting (NEAR) system is unable to calculate future minimum lease payments beyond 1999. Manual calculations to supplement the NEAR system lease payment calculations contained numerous errors, effectively understating future minimum lease payments of the Federal Buildings Fund by over $18 million. This problem was also identified during our fiscal year 1986 audit. (See item 8.)
- General ledger expense accounts were not used to derive financial statement expense line items on GSA's Statement of Revenues and Expenses. To obtain the line item classifications presented on the financial statement, GSA personnel utilized budgetary accounts, which do not link with general ledger accounts. This improper financial reporting created many opportunities for error. (See item 9.)
- The lack of adequate written guidance and the high degree of manual processing of GSA financial data led to inaccuracies and inconsistencies in the financial reporting and consolidation process. (See item 10.)
- Established accounting procedures were not always adhered to during fiscal year 1987. As a result, adjustments totaling over $2 million at fiscal year-end were needed to correct the Federal Buildings Fund's allowance for uncollectible accounts receivables and related bad debt expense accounts. In addition, adjustments totaling $0.9 million were needed to increase year-end accounts payable and work-in-process for amounts withheld from vendor invoice payments on construction contracts in the Federal Buildings Fund. (See items 1 and 7.)
- Accounts receivable subsidiary records were not adequately reviewed to detect and eliminate erroneous and outdated information. As a result,

adjustments reducing Federal Buildings Fund net income by $8.9 million were required in fiscal year 1987. (See item 3.)

- Federal Buildings Fund construction projects were not adequately reviewed to determine their status. As a result, adjustments totaling over $50 million were required to reclassify completed projects from the construction-in-process account to the building account. In addition, adjustments totaling $1.7 million were required to recognize the depreciation expense associated with the erroneously classified completed projects. (See item 6.)
- GSA lacked adequate separation of duties in some functional areas. For example, personnel responsible for reviewing inventory operations at the supply depots are also responsible for recording receipts in the inventory records. (See item 12.)
- GSA lacked written guidelines for some of its routine operations. For example, despite the fact that the Federal Supply Service Payment System (FEDPAY) has been in existence for over a year, it has no documented procedures covering the system's operations. In addition, written guidance does not exist to sufficiently illustrate procedures to be followed for the initial processing of vendor invoices for long distance telephone services. (See items 14 and 16.)

Conclusions and Recommendations

The internal accounting control weaknesses discussed in this report, including some that were previously reported to GSA, provide the agency with additional opportunities to improve its internal controls and financial management practices. The problems could affect the integrity of GSA's accounting and financial data and lead to inappropriate and inefficient use of financial resources. Accordingly, we recommend that the Acting Administrator of the General Services Administration direct the GSA Comptroller to develop a plan which includes a timetable for resolving the weaknesses identified in appendix I of this report.

Also, to assist the Acting Administrator in ensuring that actions to accomplish these improvements are progressing on schedule and to assist him in carrying out his responsibilities under the Financial Integrity Act, managers should continue to include in reports to the Acting Administrator under the act information on the status of efforts to correct the weaknesses we identified. To the extent weaknesses are not corrected by the end of the current fiscal year, they should be considered for inclusion in the Administrator's annual report required by the act.

Agency Comments and Our Evaluation

A draft of this report was provided to GSA's Deputy Director for Finance, whose comments have been incorporated into this report where appropriate. As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We look forward to working with you to continue the progress that GSA has made in improving its financial management operations.

This report was prepared under the direction of Robert W. Gramling, Director, Corporate Financial Audits. Other major contributors are listed in appendix II.

Copies of this report are being sent to the Director of the Office of Management and Budget, the Secretary of the Treasury, interested congressional committees, and other interested parties. Copies will also be made available to others upon request.

Sincerely yours,

Frederick D. Wolf
Assistant Comptroller General

Areas That Need Strengthening

Public Buildings Operations

Item 1

Procedures Are Not Followed for Establishing the Year-end Allowance for Losses on Accounts Receivable

Our examination disclosed that personnel in the Accounts Receivable Branch of Region 7's Finance Division did not follow GSA's procedures for determining the year-end allowance for uncollectible receivables and related bad debt expense for fiscal year 1987. As a result, adjustments totaling $2.3 million were needed to increase the allowance and bad debt expense accounts for the Federal Buildings Fund.

The majority of GSA's accounts receivable are with other federal agencies. The age of these receivables becomes a factor in determining their collectibility because a lapse in an agency's appropriations may leave it unable to repay the debt. GSA procedures call for the establishment of an allowance amount equal to 50 percent of the total accounts receivable which are between 12 and 24 months old. For receivables which are more than 24 months old, an allowance equal to 100 percent of their total outstanding balance is to be established. Any allowance for receivables less than 12 months old is to be established using the percentage of credit sales method. These procedures were developed to comply with applicable provisions of Title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies.

GSA should ensure that its procedures are adhered to when establishing an allowance for uncollectible accounts receivables. If standardized procedures are adhered to, consistent and accurate reporting of financial information should result.

Item 2

The Effects of Rent Chargebacks Are Not Recognized

Our audit work disclosed that GSA's accounting records do not reflect the effects of customer agency chargebacks for disputed rent billings received subsequent to fiscal year-end. In fiscal year 1987, Federal Buildings Fund revenue and thus, net income, had to be reduced $2.6 million to recognize the effects of these rent chargebacks. In fiscal year 1986, rent revenue and net income was reduced $1.6 million because of this same procedural deficiency.

Title 2 states that federal agencies are to use the accrual basis of accounting, and it requires matching (simultaneous recognition) of revenues and expenses that result directly and jointly from the same event. Title 2 defines a loss contingency as an existing condition, situation, or circumstance involving uncertainty about possible losses. It requires accrual of loss contingencies when it is probable that a liability has been incurred before the financial statements have been issued and the amount of the liability can be reasonably estimated.

GSA's current method of accounting for rent chargebacks applicable to current year operations, but received in the subsequent fiscal year, is not in conformance with Title 2. Under GSA's current practice, revenue and cash collected are recognized quarterly when rent bills are processed by a Department of the Treasury tape. If a chargeback is subsequently enacted by a customer agency disputing the bill, GSA reduces its cash account and establishes a receivable for the chargeback amount. If the chargeback is subsequently allowed, the receivable and the related revenue account are reduced. However, if the customer chargeback is initiated and subsequently allowed after the close of the fiscal year to which the billing pertains, revenue is reduced in the year in which the chargeback is allowed, not the year in which the bill was generated. This treatment is not in conformance with the matching principle, which requires the simultaneous recognition of revenues and expenses (or, in this case, reduction of revenues) resulting directly and jointly from the same event.

Historically, 85 percent of agency-enacted chargebacks are eventually allowed by GSA. In addition, experience with customer rent billings supports the contention that some chargebacks will be enacted subsequent to fiscal year-end. We believe that historical data would provide a reasonable basis for estimating an allowance based on a percentage of yearly rent billings that will be charged-back in the subsequent fiscal year, to which the historically allowed chargeback percentage could then be applied.

GSA should adhere to the matching principle in its accounting treatment of rent chargebacks and undertake an effort to estimate and record in its financial statements the effects of rent chargebacks in the same year rent income is recognized. By doing so, GSA would more accurately match revenues with the costs of generating such revenues.

Item 3

Accounts Receivable Subsidiaries Are Not Adequately Reviewed

Our audit disclosed that the Region 7 Finance Division's Accounts Receivable Branch did not review subsidiary records as part of its account reconciliation work so as to detect and eliminate erroneous and outdated information. As a result, adjustments reducing net income by $8.9 million during fiscal year 1987 were needed to recognize the uncollectibility of old unbilled receivables under reimbursable work authorizations.

GAO's Title 2 requires that general ledger balances be reconciled with subsidiary accounts and records. Implicit in this requirement is the periodic inspection and review of the subsidiary records for completeness and accuracy.

In reviewing Region 7's fiscal year-end accounts receivable reconciliations, we found that the Accounts Receivable Branch's subsidiary records supporting the receivable control account for reimbursable work authorizations were insufficient. Our detailed review revealed that, while the control account and its subsidiary records were in agreement, the validity and collectibility of $13.1 million of the account's $72 million balance was questionable due to the advanced age of the receivables. Some of the unbilled receivables dated back to 1977, and approximately $8.9 million were over 1-year old as of September 30, 1987. If a more detailed reconciliation had been performed through a review of the subsidiary information, some of these unbilled receivables might have been billed and collected. However, because of their age and the questionable validity of some of them, we proposed that the allowance for uncollectible receivables and related bad debt expense accounts be adjusted to reflect the probable uncollectibility of those unbilled receivables for reimbursable work authorizations which were over 1-year old as of fiscal year-end.

GSA should ensure that comprehensive reconciliations between control accounts and subsidiary records are performed. A mere comparison of the control account balance with the subsidiary total is not enough; finance personnel must first determine that the subsidiary records contain accurate information from which a meaningful comparison can be made. Without ensuring the validity of subsidiary records, reconciliations between subsidiaries and control accounts are meaningless, and errors in accounting information could go undetected.

Item 4

Rent Billings Are Not Always Supported By Adequate Documentation

Our audit work in fiscal year 1987 disclosed that GSA's Public Buildings Service (PBS) does not always maintain adequate documentation to support the quarterly rent bills produced by the PBS/Information System. We found that GSA could not always support the rental rates and space assignment charges billed to customer agencies. We noted similar problems during our fiscal year 1986 audit.

During our 1987 audit, we requested supporting documentation for rental rates and space assignments of square footage occupied for a nonstatistical sample of 60 rent bills covering three GSA regions. PBS appraisal and technical support chiefs were unable to provide adequate documentation to support over 18 percent of the rent space assignments and nearly 22 percent of the rent billing rates included in our sample. In the case of the billing rates, we found appraisals for all of the bills sampled; however, we found insufficient documentation to support modifications to these appraised rates prior to their input into the PBS/ Information System. For rent space assignments, either assignment documentation could not be located, or the hardcopy support found either in the assignment files or with the help of the technical support chief failed to match the assignment per the bills because of untimely updating of assignment files.

GAO's Title 2 requires that all transactions and other significant events be clearly documented and that such documentation be readily available for examination. Additionally, under 40 U.S.C. 490(j) and implementing regulations, rent established by GSA for space leased to customer agencies generally must approximate commercial rates for comparable space. Adequate documentation is needed to ensure that proper rates are being charged.

GSA should ensure that regional personnel realize the importance of maintaining documentation to support billing rates and revenue transactions and to ensure that customers are properly billed. The regional offices should maintain complete and up-to-date assignment and appraisal files as a control over the PBS/Information System data base as well as subsequent appraisals and assignments. Proper maintenance of supporting documentation and systems control would reduce the risk of inaccurate billings and entries to the accounting records.

Item 5

Repair and Alteration Projects Are Not Consistently Recorded

Our audit work disclosed that GSA is not consistently recording the costs associated with repair and alteration projects. We found that between July 1987 and October 1987 the Office of Finance made numerous manual adjustments to the accounting records to correct erroneous classifications of project costs by personnel in the PBS Repairs and Alterations Division. We noted this problem in our previous audit, in which we identified several projects whose associated costs were incorrectly capitalized or expensed.

GAO's Title 2 requires that additions, alterations, betterments, or replacements that extend the useful life or service capacity of an asset be capitalized, while costs incurred to maintain property in satisfactory operating condition be expensed. The GSA Comptroller's Handbook contains the same requirement.

We believe that the inconsistencies in how repair and alteration project costs are recorded occur because instructions for coding into the Repair and Alteration and Construction Accounting and Tracking System (RACATS), PBS's inventory system for all construction, repair and alteration projects, are unclear. As a result, Repair and Alteration Division personnel, many of whom are nonaccountants, are sometimes not sure which code is appropriate and assign the wrong code indicator. In other cases, the codes themselves are ambiguous. For example, work category code 410 is for repairing, replacing, and improving the electrical equipment, power supply, and distribution system. To be consistent with Title 2, work category code 410 would have to be broken down into two categories: a capitalized code for replacing or improving the electrical system, and an expense code for repair work. This problem was noted in our fiscal year 1986 audit, yet the code continued to be used for projects initiated during fiscal year 1987.

Our review of 16 repair and alteration projects judgmentally selected from Region 11's RACATS Work Item Inventory revealed that 9 of these projects contained erroneous information, such as incorrectly capitalizing or expensing a project's costs or miscoding one or several of the data input fields. The Office of Finance's July 1987 through October 1987 review of the entries made to record repair and alteration costs in NEAR resulted in numerous adjustments to correct erroneously classified costs. However, until the RACATS input coding instructions are adequately clarified, we believe that costs will continue to be erroneously capitalized or expensed, and if not detected and corrected, assets and net income will be misstated.

In our fiscal year 1986 report entitled Internal Controls: System Problems Affecting GSA's Financial Reporting (GAO/AFMD-88-2, dated February 4, 1988), we recommended that the Office of Finance closely monitor capitalization decisions made by the Repair and Alteration Divisions to ensure that projects are properly capitalized or expensed in accordance with Title 2. GSA has made progress in correcting the problem and was able to detect and correct many classification errors made during fiscal year 1987. However, GSA still needs to clarify the criteria for the various code indicators by removing inconsistencies and ambiguities contained in written instructions used by Repair and Alteration Division personnel when coding project information into RACATS to reduce the number of input errors at the source. Additionally, to ensure that projects receive the appropriate accounting treatment, GSA should consider having individuals with accounting knowledge review projects before they are input into RACATS.

Item 6

Completed Capital Projects in Service Are Misclassified in the Property Accounts

Our audit revealed that personnel in Region 7's Finance Division were not adequately reviewing the status of projects in the construction-in-process account to determine whether all completed capital projects had been transferred to the buildings asset account. As a result, reclassifications totaling $51 million were needed to transfer completed projects from the construction-in-process account to the building account, and adjustments totaling $1.7 million were needed to recognize depreciation expense not taken on these completed projects.

GAO's Title 2 requires that constructed property shall be accounted for at cost, and shall be capitalized when placed in service. In addition, Title 2 states that depreciation shall be recognized as an operating expense over the period in which the assets are expected to provide benefits. GSA's Comptroller's Handbook contains the same requirements.

Our review of five judgmentally selected construction projects revealed that four of the projects had been completed and placed in service during fiscal year 1987, yet their accumulated costs of $51 million had not been transferred from the construction-in-process account to the building account. In addition, no depreciation had been taken on them through September 30, 1987. Consequently, year-end adjustments were needed to reclassify $51 million between asset accounts and to recognize $1.7 million in depreciation expense. Discussions with GSA personnel revealed that the Region 7 Finance Division requires a Real Property Acquisition Advice, GSA Form 1011, from the Public Buildings Service in order to transfer a completed project to the capital accounts. Despite this requirement, the Region 7 Finance Division never received the Form 1011s from the PBS regional offices for the four construction projects noted above that had been completed and placed in service during fiscal year 1987.

GSA should insure that Real Property Acquisition Advices are promptly forwarded from PBS regional offices to the Region 7 Finance Division whenever the status of a given project or building changes. In addition, GSA should review the status of projects in the construction-in-process account periodically to determine whether they are correctly recorded or whether they are completed and should be transferred to the building account. This review could be facilitated by (1) reviewing project activity at least quarterly to determine whether additional costs are still being recorded for this project and (2) obtaining an income statement for a particular project's building number to determine whether the project is generating any revenues. Identifying construction projects which generate income provides an indication that the facility has been placed into service and that additional review is needed.

Item 7

Contract Retentions Receive Inconsistent Accounting Treatment

During our examination, we found that personnel in the Region 7 Finance Division's Accounts Payable Branch were not always recording a liability for amounts withheld from payments made on a construction contractor's invoice. As a result, adjustments totaling approximately $900,000 were needed to increase both accounts payable and the construction-in-process account.

The GSA Comptroller's Handbook requires that accounts payable be established for amounts withheld from contractor progress payments. In addition, GAO's Title 2 requires that federal agencies record a liability for any contract retentions.

Our work disclosed that accounts payable personnel were not consistently recording a liability when portions of payments stipulated on invoices were withheld from the actual payment made to the contractor, but were instead recognizing only the net amount to be paid. In our testing of a judgmental sample of construction progress payments, we found that payables had not been recorded for retentions totaling approximately $900,000. Consequently, we proposed adjustments to increase both the accounts payable and construction-in-process accounts to recognize unrecorded contract retentions. Several of the accounting technicians in the Accounts Payable Branch were unaware that a liability should be recorded for contract retentions. Discussions with regional Accounts Payable Branch personnel indicated that this was due to high staff turnover in the branch and an unfamiliarity with established procedures.

GSA should ensure that Accounts Payable Branch personnel are aware of established procedures regarding accounting recognition of contract retentions. GSA should also stress the need to record amounts withheld from construction progress payments as liabilities at the time the invoice is entered into the payment system.

Item 8

Disclosures of Future Minimum Lease Obligations Continue to Contain Errors

GSA's National Electronic Accounting and Reporting (NEAR) system, the agency's accounting system, is unable to compute future minimum rental payments associated with GSA's operating leases beyond the year 1999. We noted this problem in our report Internal Controls: System Problems Affecting GSA's Financial Reporting (GAO/AFMD-88-2, dated February 4, 1988), issued at the conclusion of our fiscal year 1986 audit. GSA agreed with our finding at that time, and prepared specifications to change the system's program for computing lease obligations. However, as indicated in the action plan developed by GSA's Comptroller to address the weaknesses identified during our fiscal year 1986 audit, the timetable for implementing such system changes was before the close of fiscal year 1988. To compensate for the system's deficiency, GSA personnel manually calculated the additional lease obligation for fiscal year 1987.

Our review of GSA's future lease obligations disclosed errors in the manner in which GSA personnel manually calculated the additional lease obligations that were not automatically generated by the NEAR system. As a result of these errors, GSA's footnote disclosure on future minimum lease payments as of September 30, 1987, was understated by $18.6 million.

GAO's Title 2 requires agencies to report future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate, and for each of the 5 succeeding fiscal years. In addition, the Treasury Financial Manual requires agencies to report the cost of the remaining portion of leases entered into on Schedule 6, Standard Form 220, Statement of Commitments and Contingencies.

While reviewing GSA's supporting calculations for its disclosure of future lease obligations, we found numerous errors in the manual calculations used to supplement the incomplete system-generated lease obligation data. We found that, for all leases contained on the NEAR system, GSA personnel calculated the additional lease obligations from January 1, 2000, through the day, month, and year of the lease's expiration. The NEAR system calculated future lease obligations through 1999, or the actual expiration date of the lease, whichever was less. Additionally, adjustments were needed for several inconsistencies we noted when comparing the NEAR system's universe of operating leases with a more accurate report on the operating lease universe supplied by the Public Buildings Service. These errors combined to understate GSA's disclosure of future lease obligations as of September 30, 1987, by $18.6 million.

GSA needs to revise the NEAR system program that calculates future minimum lease payments as soon as practical to enable it to process lease data beyond the year 1999. Implementing such a program would enhance the reliability of the lease accounting data NEAR generates and would eliminate the numerous manual calculations now required. In the interim, GSA needs to develop a set of written instructions on how to calculate future lease obligation data to supplement the NEAR system's data. Such instructions should explain how to compare and resolve any differences between the lease universes of the NEAR and PBS systems prior to calculating additional rental payments. These interim steps should provide assurance that published future lease obligations disclosures are reasonably accurate.

Financial Reporting

Item 9

Office of Finance Uses Improper General Ledger Accounts

Our work disclosed that GSA's Office of Finance does not utilize appropriate general ledger accounts to support some financial statement line items. GSA presents expenses on its Statement of Revenues and Expenses by object classification. However, because no mechanism exists for allocating the general ledger expense accounts among the object classifications, Office of Finance personnel used budgetary accounts to derive the financial statement line items. This improper financial reporting creates many opportunities for error.

GAO's Title 2 requires that information included in external reports be derived from the general ledger or accounts under general ledger control and that all financial data presented in reports be accurate.

GSA utilized budget accounts to categorize expenses in its financial statements in order to present its expenses by object classification. GSA's rationale for using the budgetary accounts, aside from the ease in which they can be grouped by object classification, is that the NEAR system generates both a general ledger and a budgetary expense entry when transaction data is entered. However, we found that not all entries to record general ledger expenses generate corresponding budgetary entries. For example, entries for unfunded expenses such as depreciation and bad debt expense do not result in budgetary entries. As a result, all expenses as recorded in the general ledger accounts are not accounted for in the budgetary accounts used to derive the financial statement line items. To compensate, a line item entitled "Contracted Services" is presented on GSA's Statement of Revenues and Expenses to account for the differences between total expenses listed in the general ledger expense accounts and the budgetary accounts. For example, our review of GSA's Federal Buildings Fund's operations disclosed that the $568.6 million reported as contracted services was, in reality, the difference between the fund's total expenses listed in the general ledger expense accounts and the budgetary accounts.

GSA should take steps to ensure that its financial statements are developed from the appropriate general ledger accounts. Developing subaccounts for the general ledger expense accounts, which would capture financial transaction data by object classification in a manner similar to the budgetary accounts, would enable GSA to support object class line items by sub-account groupings of the general ledger accounts.

Item 10

Lack of Adequate Instructions and Use of Manual Processing Affect the Financial Reporting Process

Our audit disclosed that GSA lacks adequate written guidance over the financial reporting process. Moreover, GSA still utilizes a manual process for most of the compilation of its consolidated financial statements. Both of these conditions contributed to financial reporting inconsistencies between funds and fund groups, and misunderstandings among Office of Finance personnel regarding the appropriate presentation of similar items. Our fiscal year 1986 report on GSA's internal controls noted similar conditions in the financial reporting process. In that report, we recommended that GSA establish a structured and documented process for the financial reporting process, and that GSA consider modifying the NEAR system to automate the consolidation and financial reporting process. To address this 1986 audit finding, GSA incorporated some microcomputer software applications into the fiscal year 1987 consolidation process.

GAO's Title 2 requires that financial management data be recorded and reported accurately, in the same manner throughout the agency, and should use standard definitions and classifications. Title 2 also states that an agency's accounting system, including both manual and automated components, must be documented. The Office of Management and Budget (OMB) publication "Financial Management and Accounting Objectives" states that agencies are expected to use the most economical and efficient methods of processing financial information.

In our audit, we found that the lack of detailed written guidelines covering the financial reporting process led to inconsistent treatment of similar items by Office of Finance personnel when preparing the individual fund financial statement worksheets. For example, in some instances we found that finance personnel netted bad debt expense against revenues rather than properly reporting it as an expense. However, we also believe that the high degree of manual processing of financial data in the consolidation process contributed to inaccurate and inconsistent financial reporting. Although GSA's general ledgers are automated, manual processes are still used to prepare the consolidated financial statements. While GSA has incorporated some microcomputer software applications in its consolidation effort, these applications do not prevent inaccurate preparation of fund financial statement worksheets, which are the starting point in the consolidation process. An automated consolidation process would provide for uniform treatment of similar transactions and entries, thus eliminating inconsistency in the financial reporting process.

GSA should consider modifying the NEAR system to enable the financial statement consolidation process to be fully automated. Also, GSA should develop standardized, detailed instructions covering the financial reporting and consolidation process. These instructions should cover all steps in the reporting process, beginning with the preparation of individual fund financial statements from the trial balances and the treatment of adjustments, through the consolidation of the fund statements into the agency-wide financial statements. Such standardized, detailed instructions should assist in improving both the accuracy and the consistency of financial reporting.

GSA is currently studying the NEAR system and has hired an outside contractor to develop needed structural and procedural changes.

General Supply Operations

Item 11

Perpetual Inventory Verifications Should Be Performed More Frequently

Our examination disclosed that, during fiscal year 1987, GSA's inventory surveillance teams did not perform the number of test counts required by the GSA operating manual to verify the accuracy of general supply perpetual inventory records. As a result, GSA did not have reasonable assurance that its inventory records were accurate. While our tests of the inventory disclosed no discrepancies that were considered material to the financial statements taken as a whole, we nonetheless believe that this noncompliance with established procedures for conducting inventory test counts constitutes a weakness in GSA's internal accounting controls. In our fiscal year 1986 report on GSA's internal controls, we noted similar deficiencies in adherence to prescribed inventory test count procedures. In the action plan developed by GSA's Comptroller to address the weaknesses identified during our fiscal year 1986 audit, GSA agreed to conduct more frequent inventory test counts. However, the additional test counts are not scheduled to commence before fiscal year 1988 and, therefore, problems noted in our 1986 fiscal year audit continued in 1987.

The Federal Supply Service's Supply Operations Manual requires that Inventory Surveillance Branch personnel conduct periodic counts of the general supply inventory on an ongoing basis throughout the year and that the results of these counts be used to adjust inventory records to reflect actual quantities on hand.

Our own inventory test counts conducted at the supply depots at Stockton, California, and Belle Mead, New Jersey, disclosed differences between recorded quantities and actual quantities on hand. For example, physical quantities for 11 of 22 judgmentally selected items counted at the Belle Mead supply depot and 12 of 14 judgmentally selected items counted at the Stockton supply depot were outside accepted tolerance levels. Of the total 23 out-of-tolerance items, 10 were overages and 13 were shortages. The dollar value of these items was immaterial to the financial statements taken as a whole. Nonetheless, had the respective Inventory Surveillance Branches conducted the required periodic inventory counts and adjusted the inventory records accordingly, our test counts may not have revealed such high levels of deviation between inventory records and actual inventory on hand.

GSA should take adequate measures to ensure that Inventory Surveillance Branch personnel conduct the required periodic inventory test counts at each supply depot, and analyze the results. For example, in our tests, the number of overages and shortages are approximately equal, which suggests a recordkeeping or cut-off problem. Excessive overages may indicate that the receipts of goods are not being recorded, while excessive shortages may indicate that items shipped are not being properly recorded or may indicate a theft problem. Items stored near exit doors, small concealable items, high-value items, and items with personal or commercial use are traditional areas of theft shortages and should be further investigated.

Item 12

Inadequate Separation of Duties Exists at Supply Depots

We found that GSA personnel responsible for reviewing inventory operations at GSA supply depots were also responsible for recording inventory receipts in the inventory records. For example, our review of the supply operations at the Stockton, California, supply depot revealed that GSA's Inventory Surveillance Branch personnel were performing both the inventory verification and inventory receipt recording functions. This lack of separation of duties increases the risk of errors or irregularities and is a weakness in GSA's internal accounting controls.

GAO's Title 2 states that key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.

GSA's Inventory Surveillance Branch personnel, under the direction of the Federal Supply Service, are responsible for reviewing all aspects of the general supply inventory operations in the supply depots. Chapter 28 of the Federal Supply Service's Supply Operations Manual delegated the responsibility of recording inventory receipts in the inventory records to these same personnel. Performance of both the operating and review functions by the same staff increases the risk that errors or irregularities might occur and go undetected.

GSA should correct this oversight in its procedure manual covering responsibility for recording inventory receipts and reviewing inventory operations. The Inventory Surveillance Branch personnel should maintain a level of objectivity in their inventory surveillance and review duties. The added responsibility of recording inventory receipts in the accounting records could impair this objectivity, thus weakening the internal control environment.

Item 13

Year-end Cut-off Procedures Are Inadequate To Ensure That Financial Transactions Are Recorded in the Proper Fiscal Year

Our examination disclosed that GSA's year-end cut-off procedures do not adequately ensure that all financial transactions are recorded in the proper accounting period. As a result, audit adjustments totaling $29.8 million were needed to increase fiscal year-end assets and liabilities. In our fiscal year 1986 report entitled Internal Controls: System Problems Affecting GSA's Financial Reporting (GAO/AFMD-88-2, dated February 4, 1988) we noted similar problems and identified nearly $23 million of financial transactions not recorded in the proper fiscal year.

GAO's Title 2 requires that a liability be recognized and reported in annual financial statements for goods and services received. Title 2 also requires that the liability reflect both invoices received and estimated amounts for invoices not yet received.

We found that GSA's year-end cut-off procedures are inadequate to ensure that financial transactions are recorded in the accounts in the fiscal year in which they occurred. Our testing disclosed that approximately $29.8 million of inventory purchased and received prior to fiscal year-end was not recorded in the accounts until fiscal year 1988. Discussions with Region 6 Finance Division personnel revealed that these inventory items were not recorded in fiscal year 1987. This occurred because the system which generates automated entries to update the general ledger for inventory received was temporarily shut down. Despite notice that the system would be shut down for modification, no attempt was made to compensate for the lack of automated general ledger updating through the use of manual accrual entries. As a result, both inventory and accounts payable were understated by $29.8 million at fiscal year-end.

GSA should take stronger measures to ensure that, at fiscal year-end, unrecorded financial transactions are accrued, as appropriate, and reported in the proper accounting period. Compensating controls should be in place to ensure that any shutdown of automated transaction processing does not disrupt the accuracy and reliability of the financial reporting functions.

Item 14

Operating Procedures for Finance's Fedpay System Are Not Documented

Our audit disclosed that, except for very basic operating guidelines for system hardware, no documented procedures exist for GSA's Federal Supply Service Payment System (FEDPAY). The FEDPAY system, a sub-system of GSA's NEAR system, is used by GSA's Federal Supply Service to record and pay vendors for merchandise or services purchased for federal agencies. The system interacts with other sub-systems of NEAR, such as the Federal Supply and Services-19 (FSS-19) system, the Vehicle Acquisition Production Reporting System (VAPRS), and the FSS Accounting Interface Module.

GAO's Title 2 states that systems should be clearly documented and that such documentation should be readily available for examination. The National Institute of Standards and Technology's Federal Information

Processing Standards Publication (FIPS Pubs) provides guidance on documenting accounting systems. The documentation must cover the system's development and its actual operation. Documentation must be complete, current, and maintainable. It must also be of sufficient scope and depth to provide management, users, systems operation and maintenance personnel, and auditors and other evaluators with an understanding of the design and operation of each component in the system and its relation to other components.

The FEDPAY system has been fully operational since October 1986. Despite this, documented procedures covering the detailed operating of the system have yet to be developed. Without documented operating procedures, the internal control environment is weakened, as personnel interacting with FEDPAY do not fully understand the system's operations.

To improve its controls, GSA needs to develop the necessary documentation to fully describe and explain the FEDPAY system. Appropriate criteria is contained in Title 2, Appendix III, and in the FIPS Pubs, specifically, FIPS Pubs No. 38 "Guidelines for Documentation of Computer Programs and Automated Data Systems," No. 105 "Guidelines for Software Documentation Management," and No. 106 "Guidelines for Software Documentation Maintenance." Once the documentation has been developed, sufficient resources will need to be made available to ensure that routine maintenance of that documentation is provided.

Automated Data Processing Services Operations

Item 15

Procedures for Estimating Income and Expense Accruals Are Not Documented

GSA's methodology for estimating monthly income and expense accruals for services provided by contractors was inaccurate and undocumented. Although agency officials were able to describe the methodology intended for use in estimating income and expense accruals, there were no written procedures that either addressed this methodology or required its use. This resulted in both inconsistent estimation techniques and inaccurate estimates. In half of the contracts we tested, actual costs and subsequent customer billings exceeded the accrued amounts by more than 50 percent.

GAO's Title 2 requires that reasonable estimates of the cost of services performed before the end of a reporting period be made for annual reporting purposes. This suggests that estimated costs should be reasonable representations of actual costs anticipated. The determination of such amounts should be based on a sound methodology that closely approximates actual costs.

We believe that estimated costs which deviate from actual costs by more than 50 percent are not reliable for making funding decisions or assessing program results. GSA needs to devise a standard written methodology for estimating income and expense accruals that more closely approximates actual costs and the appropriate markup of services provided by contractors. GSA should use historical cost data from the most recent contractor invoices, as such data become available, to compute these estimates. The methodology should be tested periodically and adjusted as needed to maintain a reasonably close approximation of actual costs plus markup.

Federal Telecommunications Operations

Item 16

Procedures for Processing Vendor Invoices for Long-Distance Services Are Not Adequately Documented

Our audit work disclosed that no documented operating procedures exist which provide adequate guidance on the initial processing of vendor invoices for long distance telephone services. As a result, different methodologies were used to perform tests on invoices with the possibility of errors or irregularities occurring.

GAO's Title 2 requires that an agency's accounting system be documented. It states that the documentation must be complete, current, and maintainable. Without adequate documentation, GSA must rely on the knowledge and experience of key personnel to ensure that its policies and procedures are followed.

Processing begins at GSA's Central Office component in Belleville, Illinois, and primarily involves verifying the telephone circuit usage and tariff rates on vendor invoices for long-distance services and certifying the payment amount. A certifying memorandum is then sent to Region 7's Finance Division to authorize payment, with the original invoices maintained in files at the Belleville office. Even though it is performed outside of the Office of Finance, the verifying and certifying of invoices for long distance telephone service is considered an accounting operation. Therefore, this processing is a component of GSA's accounting system. We found that, on several occasions, employees involved in complex functions in the verification and certification process were unable to explain standard GSA policies and procedures regarding certain key aspects of their work. In addition, different employees used different methodologies and techniques to perform similar tasks and frequently achieved different results. This practice can raise questions concerning the reliability of the resultant financial data and could result in payment errors.

We believe that GSA should document its procedure for verifying and certifying for payment vendor charges for long-distance services. This documentation should be explained in a training session and made readily available to all employees, particularly at the Belleville office, who are responsible for implementing these policies and procedures on a daily basis.

Item 17

Nonretention of Documentation to Support Vendor Payments for Local Telephone Services

GSA's National Capital Region (NCR) maintains source documents to support charges for local telephone services for only 6 months. After 6 months, these documents are disposed of and are thus no longer available for inspection or examination. Discussions with GSA personnel revealed that the voluminous nature of this documentation, coupled with the limited storage space at NCR, necessitates the timely disposal of the documentation. Nonetheless, without these source documents, GSA cannot adequately support expenditures made more than 6 months ago for local services in the National Capital Region. This significantly hampers GSA's ability to verify and substantiate expenditures for a 1-year operating and audit cycle.

GAO's Title 2 requires that all transactions and other significant events be documented and that the documentation be readily available for examination. GAO's Title 8 requires documents to be retained for 3 years or after audit by the GAO, whichever is earlier, assuming the documents are not required to be retained for a longer period by other applicable laws or regulations.

Because GSA does not maintain the source documents in support of charges for local telephone services in the National Capital Region for more than 6 months, the agency is unable to provide adequate supporting documentation to substantiate account balances at the end of the fiscal year. GSA should maintain all supporting vendor payment documentation in accordance with Title 8. It could do so without acquiring additional storage space by microfiching the documentation.

Other Miscellaneous Areas

Item 18

Cash Balances in Receipt Funds Are Not Properly Accounted for

GSA did not properly account for the balance of funds with Treasury in its receipt funds. These funds (095X and 096X) account for proceeds from the sale of real property. The general ledgers for those funds did not reflect the amount at Treasury at the end of fiscal year 1987. Instead, they reflected only current year activity, as cash activity in these funds from prior years had been deleted from the accounting records. Consequently, when consolidating the financial statements, GSA was unable to reconcile their cash and, therefore, reported the Treasury cash balance for the receipt funds. We also identified this problem as an internal control weakness during our fiscal year 1986 audit and included it in our report entitled Internal Controls: System Problems Affecting GSA's Financial Reporting (GAO/AFMD-88-2, dated February 4, 1988).

GAO's Title 2 specifies that an agency's financial statements shall be the culmination of its systematic accounting process. Title 2 further states that the accounting system of each agency must provide control over assets.

We also found that, in addition to the cash balance, the amounts GSA reported for equity of the U.S. government and income in its fiscal year 1987 consolidated financial statements for the receipt funds were not supported by the general ledgers. The cash and equity of the U.S. government reported in the consolidated financial statements for the receipt accounts exceeded the amounts on the general ledgers by $13.5 million. Income differed by more than $200,000. In fiscal year 1986, the cash and equity of the U.S. government accounts on the general ledger exceeded the amounts reported in the consolidated financial statements by $17 million, while income differed by more than $300,000. These differences were not reconciled or adequately explained.

According to a GSA official, the general ledger cash accounts for the receipt accounts are closed out to equity of the U.S. government at the end of the fiscal year. Therefore, the general ledger cash accounts at year-end reflected only the current year's collections and adjustments. As a result, for the cash and other line items mentioned in the preceding paragraph, there was no meaningful relationship between the amounts reported in GSA's consolidated financial statements, which were derived from the Treasury cash amounts, and the account balances recorded in the general ledgers for the receipt funds.

The above treatment was adopted, according to the same GSA official, because the cash in receipt funds is normally transferred or closed out to Treasury at the end of each fiscal year without any action on GSA's part. We do not believe that this policy is applicable to the receipt funds in question because the Administrator of GSA controls the amount of the year-end transfers made from these funds to other funds. In addition, the entire cash balance is not always transferred, so a balance remains. At the end of fiscal year 1987, for example, Treasury reported a balance of $70 million for the receipt funds. At the end of fiscal year 1986, the Treasury balance was $45.5 million.

GSA has taken steps to correct this problem. The Deputy Comptroller for Finance directed the Office of Finance to establish and maintain cumulative cash balances for the receipt funds. We believe that these steps, if properly implemented, could provide the necessary controls and procedures to properly account for the cash in the receipt funds. However, GSA should take further steps to ensure that the cash and income general ledger accounts for the receipt funds are the result of financial transactions involving the funds rather than adjustments to reflect Treasury activity and balances. These accounts should provide the basis for cash and income amounts reported in the financial statements.

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