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GAO

United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

B-250948

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November 19, 1992

Major General Richard G. Larson, USA
Commanding General
Military Traffic Management Command

Dear General Larson:

We recently completed a comprehensive review of the U.S. Army's financial management operations and systems. The primary objectives of that review were to assess the Army's internal control systems and audit the fiscal year 1991 financial statements pursuant to the Chief Financial Officers Act of 1990 (Public Law 101-576). As part of the review, we engaged an independent certified public accounting firm, Arthur Andersen & Co., to perform the audit of the Military Traffic Management Command (MTMC).

We conducted our review of the auditors' work in accordance with generally accepted government auditing standards. To determine the reasonableness of the auditors' work and the extent to which we could rely on it, we

-- reviewed the auditors' approach and planning of the audit;

-- evaluated the qualifications and independence of the audit staff;

-- reviewed the auditors' reports to evaluate compliance with generally accepted accounting principles and generally accepted government auditing standards; and

-- reviewed the auditors' working papers to determine (1) the nature, timing, and extent of audit work performed, (2) whether the auditors obtained an understanding of MTMC's internal control structure, (3) whether the auditors tested transactions for compliance with applicable laws and regulations, and (5) whether the evidence in the working papers supported the auditors' opinion on the internal control structure.

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Arthur Andersen & Co.'s enclosed report on internal controls, with which we concur, suggests improvements to the internal control structure, financial reporting, and compliance with regulations at MTMC. Specifically, the following weaknesses were identified at MTMC:

-- accounts payable were not promptly recorded,

-- year-end accruals were not properly recorded,

-- contingent liabilities were not recorded,

-- accounts receivable were not analyzed or properly recorded,

-- fixed assets were not promptly accounted for or reconciled quarterly, and

-- returned lumber inventory had not been recorded.

Three common areas of concern underlie the findings by Arthur Andersen & Co.: (1) not recording known accounting transactions promptly, (2) failure by other organizations within MTMC to notify accounting personnel promptly about potential accounting transactions, and (3) not following existing regulations. These conditions can cause MTMC's financial information and reports to be misleading and can negatively affect decisions that are based in whole or in part on this financial data. We are sending the independent public accounting firm's report to you so you can initiate appropriate corrective actions.

We would appreciate receiving your comments on these matters and a description of corrective actions within 30 days. We are also sending copies of this letter to the Assistant Secretary of the Army for Financial Management; the Director, Defense Finance and Accounting Service; and the Comptroller of the Army. If you have any questions, please contact me on (202) 275-7095.

Sincerely yours,

David M. Connor

David M. Connor
Director, Defense Financial Audits

Enclosure

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Arthur Andersen & Co.

1345 Avenue of the Americas
New York NY 10105

October 15, 1992

To the Director, Defense Financial Audits:

We have evaluated the effectiveness of internal controls at the Military Traffic Management Command (MTMC) which is a component of the United States Department of the Army. We performed this work in conjunction with our audit of the statement of financial position of MTMC as part of the Army's consolidated financial statements for the period ending September 30, 1991. In planning and performing our audit of the statement of financial position of MTMC as of September 30, 1991, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the statement of financial position and not to provide assurance on the internal control structure.

We conducted our audit in accordance with generally accepted auditing standards and the standards for financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatements.

The management of MTMC is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal control structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

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In connection with our audit of MTMC's statement of financial position as of September 30, 1991, we visited the following locations:

- MTMC Headquarters -- Falls Church, Virginia;
- MTMC Eastern Area Command -- Military Ocean Terminal, Bayonne, New Jersey;
- -- Military Ocean Terminal, Sunny Point, North Carolina; and
- MTMC Western Area Command -- Military Ocean Terminal, Oakland, California.

The assets physically located at, or controlled by, the above locations represent in excess of 90 percent of the assets reported in MTMC's statement of financial position at September 30, 1991. We were not engaged to audit MTMC's statement of operations for the year ended September 30, 1991. We completed our audit work on January 15, 1992, and we have not performed audit procedures subsequent to that date.

For the purpose of this report, we have classified the significant internal control structure policies and procedures into the following categories:

- Fixed assets,
- Inventory,
- Accounts receivable,
- Accounts payable,
- Accrued liabilities and other commitments and contingencies,
- Expenditure--Purchasing,
- Expenditure--Payroll,
- Revenue, and,
- Treasury functions.

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted several items involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect MTMC's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

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Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that were also considered to be material weaknesses as defined above. We believe each of the reportable conditions described below is a material weakness. The following reportable conditions/material weaknesses were exacerbated by the significantly increased volume of workload generated by Operations Desert Shield and Desert Storm.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of MTMC in a separate letter, dated January 15, 1992.

1. Accounts Payable Not Recorded On A Timely Basis

MTMC Regulation 37-1, chapter 9, prescribes procedures for the recording and payment of accounts payable based on the receipt of goods and services. Specifically, paragraph 9-4, requires that accounts payable be recorded based on receiving documents, and paragraph 9-5 requires that invoices, receiving documents and the accounts payable subsidiary records be matched prior to processing payments.

As part of our analysis of cash disbursements, we statistically selected 115 cash disbursement vouchers from fiscal year 1991. We traced these vouchers to the receiving reports and related contracts in order to ensure that the payments were for valid liabilities owned by MTMC and that the accounts payable were recorded promptly.

For the disbursement vouchers that we traced, we did not find any instances where liabilities were paid without appropriate approvals and documentation. However, for 14 of the 115 vouchers recorded as paid during fiscal year 1991, MTMC did not record an account payable until 1 to 5 months after the vendor had been paid.

This occurred because MTMC does not follow existing procedures for recording receiving reports on a timely basis. Accordingly, MTMC lacks assurance that its liability for accounts payable are fairly stated. Following existing procedures to ensure that liabilities are promptly recorded will help correct this condition.

2. Year-End Accruals Not Properly Recorded

MTMC is using the "prior period adjustment" account in lieu of recording routine accrual transactions at year-end which may include some of the accounts payable discussed in the previous section. In addition, when all material transactions are not identified prior the issuance of the financial statements, an alternative

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accounting treatment is provided for such circumstances. Army Regulation 37-1, table 4-2, provides for an account, "prior period adjustments" which should be used to record such material transactions. The regulation requires a detailed explanation in a footnote to the financial statements to describe the circumstances of the adjustment.

In order to determine whether transactions were recorded in the correct period, we judgmentally selected 122 subsequent cash disbursements processed during October, November and December of 1991, and reviewed receiving reports to determine if the payments were for services performed prior to September 30, 1991. We found that 15 of the 122 disbursements applied to goods and services received during fiscal year 1991. These were recorded as a "prior period adjustment" rather than as a year-end accrual (accounts payable) as of September 30, 1991.

In addition, we analyzed MTMC's prior period adjustment account as of October 1991. While individual transactions in October were immaterial, the net results of the October 1991 prior period adjustments materially increases (40 percent increase), the total fiscal year 1991 restated net results.

The following is a restatement of the total revenues and expenses recorded in the September 30, 1991 financial statements to include the activity in the fiscal year 1992 "prior period adjustment" account as of October 31, 1991.

Table 1: Restatement of the Fiscal Year 1991 Total Revenues, Expenses and Net Results

	Fiscal year 1991 total revenue and expenses as of September 30, 1991	Prior period adjustment account balance as of October 31, 1991	Restatement of fiscal year 1991 total revenues and expenses as of September 30, 1991
	----------Dollars in Millions----------		
Revenues	$ 546	$ 16	$ 562
Expenses	(549)	(18)	(567)
Net Results	$(3)	$(2)	$(5)

We also reviewed the status of the "prior period adjustment" account as of December 31, 1991, and found that the net loss had grown from $2 million in October to nearly $11 million. Again even if the individual transactions were immaterial, the December 1991 "prior period adjustment" account would have materially increased the fiscal year 1991 loss from $3 million to $14 million.

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We suggest MTMC follow Army Regulation 37-1, paragraph 4-2, to properly record all year-end accruals and limit use of the "prior period adjustment" account to only those transactions which are individually material and to properly disclose all activity in the footnotes.

3. Contingent Liabilities Not Recorded

Army Regulations 37-1, paragraph 23-7, requires that a loss be reported in the financial statements if it is probable that, (1) as of the date of the financial statements, a liability has been incurred, and (2) the amount of the loss/liability can be reasonably estimated. If one or both of these conditions for the accrual of such a loss cannot be met, disclosure of the contingent liability in the footnotes to the financial statements is required.

MTMC has a post contract adjustment policy when contracting for stevedore services. Under this policy, contractors may claim additional compensation if the actual workload is greater than the estimated workload projected by MTMC during the original negotiations. As of January 1992, MTMC had been notified of $15 million in claims from stevedores which these contractors attributed to the increased workload required to keep ports open around the clock during Operations Desert Shield and Desert Storm. At a minimum, MTMC should disclose the amount of these claims in the footnotes to the financial statements.

This condition may have arisen because MTMC does not have procedures which require the Contracting Officer to notify the Finance and Accounting Officer of possible contingencies. Without the notification of possible contingencies, financial personnel are unable to determine the correct financial disclosure. MTMC management should implement procedures to ensure that Army Regulation 37-1, paragraph 23-7, is routinely followed.

4. Accounts Receivables Not Analyzed Or Properly Recorded

We reviewed MTMC's billing process and found that the MTMC Finance and Accounting Office does not have complete control over billing data. Of the $81 million in accounts receivable as of September 30, 1991, $33 million are over 30 days old. According to MTMC officials, the large percentage of the older accounts were caused by erroneous data in the billing process -- particularly the data which identifies the customer to be billed. The Transportation Officers, throughout the military services, prepare shipping documents according to Department of Defense (DOD) procedures, but the four digit codes used to identify specific customers were often inaccurate or invalid.

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Once the goods are shipped, the shipping document is used by the financial system to generate the bills. MTMC operations personnel within transportation receive a listing of inaccurate billing codes periodically. However, since these codes do not affect the shipment of goods and existing DOD manuals containing valid codes are not always kept up to date, corrective action is not always taken immediately. As a result, many bills that MTMC sent were returned or remained unbilled. At this point, erroneous data is often months old. However, the Finance and Accounting Office does attempt to research these bills by working with the operations personnel.

Army regulations require receivables to be analyzed by aging to identify delinquent balances. MTMC's regulation 37-1, paragraph 6-8, requires four categories of delinquent and unbilled receivables. MTMC included the following schedule in its September 30, 1990 and 1991 financial statements:

Table 2: Aging of Accounts Receivable as of September 30 for Fiscal Years 1990 and 1991

	1990		1991	
Days aged	$ in Millions	Percent of Total	$ in Millions	Percent of Total
0 - 30	$34	57	$48	59
31 - 60	5	8	11	14
61 - 90	7	12	2	2
Over 90	14	23	20(a)	25
	$60	100	$81	100

(a) This amount does not include approximately $1 million considered uncollectible which is due from a commercial shipping company which is in bankruptcy.

However, Army Regulation 37-1, paragraph 15-34, requires that all accounts receivables over 90 days be aged in more detail than MTMC's regulation. Specifically the Army requires an analysis to show receivables over 90 days in categories of 91 through 120 days, 121 through 180 days, 181 through 360 days, greater than 1 year but less than or equal to 2 years, greater than 2 years but less than or equal to 3 years. Of the $20 million reported as over 90 days, about $12 million was at least 120 days overdue, with almost $5 million outstanding for over 1 year.

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In order to analyze and properly record accounts receivable, we suggest that MTMC update its Regulation 6-8 so that it includes a more detailed breakout of delinquent and unbilled accounts, consistent with Army Regulation 37-1, paragraph 15-34. Additionally, we suggest that MTMC, in conjunction with DOD, analyze the existing procedures relating to MTMC's billing process and take action to correct the coding problems discussed above.

5. Fixed Assets Not Promptly Accounted For Nor Reconciled Quarterly

MTMC Regulation 37-1, paragraph 8-8, requires that capital assets be recorded based upon the receiving report. In addition, paragraph 8-9 requires quarterly reconciliations between the records maintained by the Finance and Accounting Officer and the property books maintained by the Responsible Property Officer.

From January through July, 1991, MTMC accepted delivery of approximately 1,100 military export containers having a value of about $12 million that were not recorded until the first quarter of fiscal year 1992. We also found that the reconciliations were not performed quarterly. MTMC should follow existing procedures to assure that all assets it receives are recorded in the accounting records when received and that quarterly reconciliations are performed.

6. Returned Lumber Not Recorded On A Timely Basis

MTMC maintains a lumber inventory which is used to partition the ships for hauling various types of cargo, such as ammunition. After Operations Desert Shield and Desert Storm, MTMC received in excess of 50 million board feet of used lumber at its Sunny Point, North Carolina, facility. Army Regulation 37-1, paragraph 16-4, requires that financial control be maintained over material returned to inventory. MTMC does not maintain financial control until such time as the reclamation process is complete. The reclamation process consists of restoring the lumber to a usable condition, which can be several months after receipt of the lumber at the port facility. At any point in time there is no estimate made as to the value of inventory to be reclaimed in the future. At September 30, 1991, the financial personnel at MTMC believed that the value of the lumber on hand and not reclaimed was insignificant and did not record or report it. We believe that MTMC should follow the existing regulations and on a timely basis maintain financial control over this lumber to the extent the amounts of reclaimed lumber warrants such control.

This document is intended for the information of the Director, Defense Financial Audits. However, this document is a matter of public record, and its distribution is not limited.

Very truly yours,

Arthur Andersen & Co.

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