Department of
Veterans Affairs

Office of Inspector General

Management Letter:
Accuracy of Non-Expendable Equipment Financial Information

Report No.: 7AF-G10-086
Date: May 12, 1997

Office of Inspector General
Washington DC 20420

Department of
Veterans Affairs

Memorandum

Date: May 12, 1997

From: Director, Financial Statement Audit Operations Division (52CF)

Subj: Management Letter: Accuracy of Non-expendable Equipment Financial Information, Report No. 7AF-G10-086

To: Deputy Assistant Secretary for Financial Management (047)
Chief Financial Officer, Veterans Health Administration (17)

1. As part of our audit of the Department of Veterans Affairs Fiscal Year 1996 Consolidated Financial Statements, we evaluated internal accounting controls over property, plant, and equipment (PP&E). We have separated our observations into three management letters with the objective of improving communication and providing suggestions to the management levels where it can be the most helpful. The purpose of this management letter is to provide details of the results of our audit tests concerning non-expendable equipment, and generally addresses issues and actions needed at the medical centers to improve accuracy and internal controls over equipment. The other two management letters provide: (a)[1] an overview of PP&E issues and actions needed by the Veteran Health Administration (VHA), Chief Financial Officer (CFO) to improve internal controls and data accuracy, and (b)[2] internal controls over real property and the actions generally needed at medical facilities to improve internal controls and reporting of real property data. Although improvements were made in the controls over and reporting of non-expendable equipment, we found a number of errors and internal control weaknesses concerning equipment. Continuing efforts are needed at the station level to help ensure that:

- Acquisition values and dates, of equipment items are correctly recorded in the general ledger and Fixed Asset Subsystem.

- Reconciliations of equipment accounts are completed and appropriate adjustments are made.

- Physical inventories of equipment are completed as required.

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[1] Management Letter "Management Oversight of Property, Plant, and Equipment Financial Information" Report No. 7AF-G10-085.
[2] Management Letter "Accuracy of Real Property Financial Information," Report No. 7AF-G10-087.

Deputy Assistant Secretary for Financial Management (047)
Chief Financial Officer, Veterans Health Administration (17)

2. Details of our audit observations are discussed in the enclosure. The types of errors noted could, if not corrected, result in future qualification of VA's Consolidated Financial Statements. Accordingly, we encourage facility managers to continue efforts to improve internal accounting controls and the accuracy of equipment financial information.

3. We appreciate the assistance provided to the audit staff. If you want to discuss the contents of this report or if you need additional information, please contact Mr. Garry Martin at (202) 565-9404 or me at (202) 565-7013.

For the Assistant Inspector General For Auditing

(Original Signed By:)
John E. Jonson
Director, Financial Statement Audit
Operations Division

Enclosure

cc: Veterans Health Administration, Director, Report Review and Analysis Service (105E)
Veterans Benefits Administration, Director, Office of Resource Management (24)
National Cemetery System, Director, Office of Operations Support (402)

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PURPOSE

As part of our audit of the Department of Veterans Affairs (VA) Fiscal Year (FY) 1996 Consolidated Financial Statements (CFS), we evaluated internal accounting controls over non-expendable equipment and tested the accuracy of reported financial data for equipment assets. We found that much progress has been made in correcting deficiencies noted in prior audits concerning equipment and related depreciation account balances. Veterans Health Administration (VHA) Chief Financial Officer (CFO) staff worked with medical facilities to reconcile and adjust their general ledger property, plant, and equipment (PP&E) accounts to the subsidiary ledger and performed analytical reviews of general ledger accounts to identify and correct errors and irregular balances. However, we found a number of errors and internal control weaknesses, noted below, that could, if not corrected, result in future qualifications of VA's CFS.

- Recording errors in both the acquisition value and date in the Fixed Asset (FA) Subsystem and/or the value in the general ledger.
- Reconciliations not performed as required.
- Physical inventories of equipment not completed as required.

These errors and internal control weaknesses continue to occur because staff at some facilities were unfamiliar with basic accounting principles and changes brought about by the implementation of the FA Subsystem and Automated Engineering Management System/Medical Equipment Reporting System (AEMS/MERS).

BACKGROUND

Definition of PP&E. Property, Plant, and Equipment is divided into two basic groups. Real property, consisting of land, buildings, improvements and other structures; and, equipment, including computer programs. VA policies usually address real property and equipment separately, since fund sources and transaction processing is different.

Financial System. The Financial Management System (FMS) is VA's principal financial system. In April 1995, facilities started installing the FMS FA Subsystem, Fixed Asset Package (FAP), for real property assets, however equipment information was not added to the system until June 1996. The system computes depreciation and contains detailed data (e.g., acquisition cost and date, and estimated useful life) for each asset. In June 1996, facilities implemented AEMS/MERS which is a centralized data base residing in FAP, which contains data on equipment (non-expendable equipment which was transferred from the prior subsidiary records[3]). AEMS/MERS was originally developed for Engineering Service and has now evolved into a shared package as part of the system to account for and track PP&E.

Equipment Capitalization. Non-expendable equipment valued at $5,000 or more and a useful life of 2 years or more, should be capitalized in the FAP. The acquisition value should consist of (1) all amounts paid to the vendor; (2) transportation charges; (3) handling and storage costs; and (4) labor (including purchase and hire), materials, and supplies. The acquisition date should be the date that the facility received the equipment item (i.e., date on the receiving report). The useful life is the estimated number of years for which the asset is projected to provide useful and economical service. The FAP automatically records the useful life based on the item's category stock number.

Account Reconciliations. VA policies state that monthly reconciliations should be made to compare the balances in the general ledger accounts with the totals of the related FAP records to help ensure the accuracy of related fixed asset account balances.

Physical Inventories. VA facilities are required to perform physical inventories of non-expendable equipment and reconcile the inventory counts to accountable records. Facility staff use the last inventory date and accuracy rate for each Consolidated Memorandum Receipts[4] (CMR) to determine when the next inventory should be performed. If the accuracy rate of the last inventory is 100 percent, the next inventory should be completed within 2 years; if the accuracy rate is between 95 percent and 99 percent, the next inventory should be completed within 12 months; and if the accuracy rate is below 95 percent, another inventory should be performed within 6 months (VA Handbook Part 4 Sec. 5302.3-b1).

Bar-coding Equipment. To help identify equipment and facilitate the physical equipment inventory process, VA Medical Centers (VAMCs) were provided bar-coding equipment. The use of bar-codes on equipment helps quickly identify the item, reduces the time for conducting inventories, and increases the accuracy of the inventories. This is because facility staff do not have to manually verify equipment identification numbers.

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[3] The Logistics, Integrated Procurement, Storage, and Distribution (LOG) System.
[4] A list of equipment items that belong to an activity or section within a facility.

SCOPE

The objective of this part of the CFS audit was to determine whether equipment account balances were accurate, and if internal controls were implemented. To achieve this objective we performed two significant audit tests: (1) verified, through the use of questionnaires and site visits, the accuracy of data recorded in the FAP and general ledger for selected equipment, and (2) visited 45 VAMCs to evaluate accounting controls over equipment financial data.

Equipment Sample Data. As of September 30, 1996, there were 140,765 equipment items in the FAP with a total acquisition value of $3.9 billion. We selected 479 ($159.8 million) equipment items for review that had acquisition dates between October 1, 1994 and September 30, 1996 (from a sample universe of 25,753 items totaling $722.7 million). We selected our sample from the latest 2 years because supporting documentation was not readily available, or no longer existed, for older assets. The 479 items selected for review were in 2 strata. The first stratum consisted of all 79 items that had an acquisition value of $1 million or more. The total value of these 79 items was $150.3 million. The second stratum consisted of a statistical sample of 400 items selected from all items valued under $1 million; the value of these 400 items totaled $9.5 million.

For the 479 items, we sent a questionnaire to 170 VA activities which included VAMCs, regional offices, cemeteries, and support activities. We requested these activities to verify the accuracy of data in the FAP (i.e., acquisition value, and date, and useful life) and provide copies of supporting documentation. In addition, we followed up on selected questionnaire responses by telephoning appropriate facility staff and by visiting VAMCs.

Visits to VA Medical Centers. We visited 45 VAMCs to evaluate internal accounting controls for equipment. We interviewed appropriate facility staff in Fiscal Service and Acquisition and Materiel Management Service. Also, we evaluated equipment inventories, account reconciliations, and the use of the bar coding equipment.

RESULTS OF AUDIT TESTS

Action Is Needed to Improve the Accuracy of Financial Data for Non-expendable Equipment

Our audit disclosed that the accuracy of data recorded in the FAP needed improvement. We found a number of errors in the acquisition value and dates for equipment items. This occurred primarily because equipment asset data was incorrectly entered into the FAP. We found that 105 of the 479 equipment items reviewed had one or more errors in the recorded acquisition cost (55 items) and/or acquisition date (56 items). The impact of these errors on the equipment and related depreciation accounts were:

- For 79 high-dollar value items, the net impact of the errors overstated the equipment account by $15.6 million, overstated the FY 1996 depreciation account by $760,000, understated the prior years' depreciation account by $1.5 million, and understated the accumulated depreciation account by $8.4 million.

- For the 400 statistically sampled items, the net impact of the errors overstated the equipment account by $15,000, overstated the FY 1996 depreciation account by $13,000, understated the prior years' depreciation account by $2,000, and understated the accumulated depreciation account by $149,000.

- By projecting the results of our sample over the whole universe, there was an estimated $969,000 overstatement of the equipment account, a $823,000 overstatement of FY 1996 depreciation, a $9.6 million understatement accumulated depreciation, and a $133,000 understatement of prior year depreciation.

Recording Errors

<u>Acquisition Cost Errors</u> Fifty-five of the 105 equipment items had errors in the acquisition cost recorded in the FAP. Incorrect costs were entered primarily because (1) administrative errors were made; (2) equipment not received was capitalized; and (3) handling/shipping costs and cost of component parts were not capitalized. Examples are:

- A VAMC improperly capitalized an equipment item costing $4 million on May 10, 1996. This item should not have been capitalized because it was not delivered to the VAMC as of September 30, 1996. As a result, the equipment account as of September 30, 1996, was overstated by $4 million, and the FY

1996 depreciation expense and accumulated depreciation accounts were overstated by $156,600 each.

- At another VAMC, an equipment item was erroneously recorded with an acquisition cost of $7,293,900 instead of its actual cost of $72,939. This occurred because facility staff erroneously added 2 extra zeros to the cost amount, causing the equipment cost to be overstated by $7,220,961. In addition, this error overstated: (1) the FY 1996 depreciation expense account by $241,180; (2) the prior year depreciation expense account by $722,096; and, (3) the accumulated depreciation account by $963,276.

<u>Acquisition Date Errors</u> Fifty-six of the 105 equipment items had erroneous acquisition dates recorded in the FAP. These errors primarily resulted from administrative posting errors or using the wrong dates. The receipt date annotated on the receiving report should be used as the acquisition date in the FAP. However, other dates were recorded, such as the purchase order date, partial receipt date, and installation date. In other instances, a specific date was not recorded; when this occurred, the system automatically recorded the first day of the month. As a result, the depreciation expense and accumulated depreciation account balances were incorrect because the system uses the acquisition dates to calculate depreciation. For example:

- For an item costing $1.5 million, facility staff incorrectly recorded the date that the equipment was installed (May 1, 1996) instead of the receiving date (September 17, 1993). This error understated the FY 1996 depreciation expense account by $59,774 and the accumulated depreciation account by $268,160.

- For an item costing $1.1 million, facility staff incorrectly recorded the purchase order date (April 24, 1996) instead of the receiving date (August 7, 1996). This error overstated the FY 1996 depreciation and accumulated depreciation accounts by about $31,500.

Reconciliation of Equipment General Ledger Accounts to the FAP Totals Would Improve the Accuracy of Equipment Financial Data

About 20 percent (9 of the 45) of the VAMCs reviewed did not perform monthly reconciliations of equipment accounts as required. For example, facility staffs did not complete one or more of the required monthly reconciliations of equipment accounts during the fourth quarter of FY 1996. When balances did not reconcile, staff at 18 VAMCs said that, due to lack of time for adequate research, they made unsupported adjustments to the equipment accounts. For example, one facility added over $7 million to their general ledger equipment account to balance to the FAP that contained a $7 million error. Complete reconciliations each month would help identify and resolve variances before they become major problems.

Improvements Are Needed to Ensure Accurate and Timely Physical Inventories of Non-expendable Equipment

Historically, VA activities have had problems with conducting timely and accurate inventories of non-expendable equipment. We found that equipment on many CMRs were not inventoried on time, as required by VA policy. In addition, many VAMCs were not using available bar-coding equipment to conduct their inventories. Use of this equipment would facilitate conducting inventories and improve the accuracy of the inventories. Timely and accurate equipment inventories are essential for ensuring that equipment is accounted for, adequately safeguarded, and missing items are detected.

<u>Equipment Inventories Were Not Performed On Time</u> Twenty-six out of 45 VAMCs had one or more delinquent CMR inventories during FY 1996 (i.e., these inventories should have been performed in FY 1996, but the inventories were not completed). Eleven of the 45 VAMCs had not inventoried over 25 percent of their CMRs. The acquisition value of the CMRs not inventoried totaled $308.9 million which was over 18 percent of the $1.7 billion of equipment at the 45 VAMCs reviewed. The major reason for delinquent equipment inventories was that facility managers did not emphasize and monitor the timeliness of CMR inventories, and did not follow-up on delinquent inventories. Examples of CMR inventories not performed on time were:

- At one VAMC, the Chief of A&MM did not sign the annual letter to facility activities requesting that CMR inventories be performed. Consequently, at this VAMC, none of the 149 CMRs totaling $49.3 million had been inventoried since FY 1995.

- At a second VAMC, 83 CMRs totaling $18.9 million were not inventoried during FY 1996. Our inventory of 215 research equipment items disclosed that 102 of the items ($548,124) could not be located. An inventory of research equipment had not been made in over 2 years.

- A third VAMC had 16 CMRs (totaling $9.5 million) that were not inventoried during FY 1996. A Service, whose CMRs had not been inventoried, could not locate 6 equipment items totaling $490,349. The Chief of Personal Property

Management (PPM) stated that this occurred because of a lack of emphasis on completing the inventories.

- A fourth VAMC had 10 CMRs totaling $11.5 million that were not inventoried during FY 1996. Subsequent review indicated that one of the CMRs had equipment items totaling $2.1 million that could not be located. Facility staff stated that this occurred because of inconsistent reporting of property data to PPM by the service. The CMR had not been inventoried since 1993.

- A fifth VAMC had 11 CMRs totaling $1.4 million that were not inventoried during FY 1996. During our review, 21 equipment items totaling $344,000 could not be located.

<u>Bar-coding System Was Not Used To Perform Equipment Inventories</u> Forty-one (90 percent) of the 45 VAMCs reviewed had bar-coding equipment on hand. However, 21 of the 41 facilities did not use bar-coding equipment to perform equipment inventories during FY 1996. VAMC staff stated that the bar-coding equipment was not used because: (1) equipment and room locations had not been tagged with a bar code; (2) they had problems with bar-coding software and scanning equipment; and (3) management had not decided when to implement bar-coding. For example:

- A VAMC had acquired bar-coding equipment several years ago, but the responsible CMR officials did not implement bar-coding. Although the VAMC is scheduled to receive additional bar coding equipment, facility staff have not made plans of when or how they will implement bar-coding. This facility had 25 CMRs totaling $2.9 million that had not been inventoried during FY 1996.

- Another VAMC did not use bar-coding because of on-going construction, which prevented the bar-coding of some door ways at the VAMC. Facility staff stated implementation of bar-coding could be delayed for a year. However, we believe that the VAMC should begin bar-coding of equipment located in areas not affected by the construction. This VAMC had 74 CMRs totaling $11.2 million that were not inventoried during FY 1996.

Bar-coding equipment is available at most VAMCs. In addition, the Office of Acquisition and Materiel Management recently purchased over $700,000 in additional bar code scanning equipment for VAMCs. However, many VAMCs were not using the bar-coding equipment already on hand. We believe that greater use of the bar-coding equipment would improve equipment identification, help facilitate conducting equipment inventories, and improve the accuracy of the inventories, because facility staff do not have to manually verify equipment identification numbers. For example:

- Staff at one VAMC staff stated that as a result of using bar-coding to conduct inventories, more items were found than had been previously recorded on the CMRs.

- Another VAMC implemented bar-coding in January 1995. Since then, no inventory adjustments were needed.

CONCLUSION

Much progress has been made in improving equipment tracking systems and correcting equipment and related depreciation account balances, resulting in the removal of the prior year CFS qualification. However, accounting errors still existed and, if not corrected, may result in future qualification of VA's CFS. Accordingly, we encourage financial managers to increase efforts to perform financial reconciliations and analytical reviews of equipment general ledger and FAP data and provide additional guidance and training to accounting staff involved in processing equipment transactions, accounting entries and performing reconciliations, physical inventories, and account analysis. Actions should be taken to reemphasize or establish local controls and procedures to help ensure that:

- Acquisition data (e.g., acquisition cost and date, for equipment) is accurately inputted into the FAP.

- Equipment reconciliations and appropriate adjustments are completed as required.

- Equipment acquisition values include (1) all amounts paid to the vendor; (2) transportation charges; (3) handling and storage costs; and, (4) labor (including purchase and hire), materials, and supplies.

- Inventories are completed correctly and on time by advising appropriate managers and employees to (1) maintain a suspense file of CMR inventories; (2) follow-up on delinquent inventories; (3) notify the facility director of delinquent inventories; and, (4) require responsible officials to certify that the equipment inventories were conducted in accordance with applicable VA policies.

- Local management controls over equipment accountability is strengthened and that (1) items moved between different activities are documented in the accountable records; (2) non-VA equipment is not commingled with VA items; (3) equipment removed from VA facilities is documented; and, (4) all equipment items are marked with tags or bar code labels.

- The use of bar-coding for tracking equipment and conducting inventories is maximized.