



Office of Inspector General

Management Letter: Accuracy of Real Property Financial Information

Report No.: 7AF-G10-087

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 Real Property Financial Information, Report No. 7AF-G10-087

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 (VA) Fiscal Year (FY) 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 real property, and generally addresses issues and actions needed at the medical centers to improve controls over buildings and improvements. 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 non-expendable equipment and the actions generally needed at medical facilities to improve internal controls and reporting of equipment. Although improvements were made in real property control and reporting, we found a number of errors and internal control weaknesses concerning real property. Continuing efforts are needed at the station level to help ensure that:

- Acquisition values and dates, and useful lives of real property items are correctly recorded in the general ledger and Fixed Asset Subsystem.
- Reconciliations of real property accounts are completed and appropriate adjustments are made.
- Costs in the construction work-in-process are capitalized when the resulting building or improvement is put into service.

¹ Management Letter "Management Oversight of Property, Plant, and Equipment Financial Information," Report No. 7AF-G10-085.

² Management Letter: "Accuracy of Non-expendable Equipment Financial Information," Report No. 7AF-G10-086.

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

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

TABLE OF CONTENTS

Page

Memorandum to:

Deputy Assistant Secretary for Financial Management (047) Chief Financial Officer, Veterans Health Administration (17).....	1
--	---

ENCLOSURE

I. PURPOSE, BACKGROUND, AND SCOPE.....	1
II. RESULTS OF AUDIT TESTS.....	4
Controls Need Strengthening to Ensure the Accuracy of Financial Data for Real Property.....	4
Conclusion.....	8

PURPOSE, BACKGROUND, AND SCOPE

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 and tested the accuracy of reported financial data for real property assets. We found that much progress has been made in correcting deficiencies noted in prior audits concerning real property 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, indicated below, that could, if not corrected, result in future qualifications of VA's CFS.

- Errors occurred in recording the acquisition values, acquisition dates, and useful lives of real property items in the Fixed Asset Subsystem and/or the value in the general ledger.
- Reconciliations of real property account balances were not completed as required.
- Costs in the construction work-in-process not capitalized when the resulting building or improvement was put into service.

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 Financial Management System (FMS) Fixed Asset (FA) Subsystem.

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. 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 for each asset. Real property information in the FAP includes acquisition value and date, and the estimated useful life of the item.

VA Capitalization Criteria. Real property, acquired either by construction, purchase, transfer, donation, trade-in, or exchange, should be capitalized when the acquisition cost is \$5,000 or more, and the asset's projected useful life is 2 years or more. Real property contracts which are part of the same project should be capitalized when the total aggregate cost of the project is \$5,000 or more, even if the individual components cost is less than \$5,000. Systems (alarms, sprinklers, etc.) which service more than one building or structure should be recorded as a separate asset in the FAP. The acquisition value should include (1) labor, material, and supply costs; (2) architectural and engineering (A&E) costs; and (3) site preparation costs. The acquisition date should be the date that the facility placed the asset into service (this information should be obtained from Engineering Service). The useful life is the estimated number of years the asset is projected to be in service.

Construction Work-in-Process (WIP). Project costs related to buildings, structures, and facilities under construction should be accumulated in the WIP account or charged directly to expense, as appropriate, if it does not meet the capitalization criteria. Subsequently, these costs will either be capitalized in the asset accounts when the property is placed in service or written off (i.e., cancellation of project).

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.

SCOPE

The objective of this part of the CFS audit was to determine whether real property account balances were accurate, and if internal controls were implemented. To evaluate the accuracy and reliability of financial data for real property as presented in VA's FY 1996 CFS, we performed two significant audit steps: (1) we nationally sampled 416 real property items to validate the accuracy of acquisition value and date, and useful life of each recorded building or improvement asset; and (2) we

visited 45 selected VA Medical Centers (VAMC) to test the adequacy of internal accounting controls over financial transactions for real property.

Real Property Data. As of September 30, 1996 there were 41,438 real property items in the FAP totaling \$12.7 billion. We selected 416 (\$702.7 million) real property items for review that had acquisition dates between July 1, 1995 and September 30, 1996 (from a sample universe of 3,080 items totaling \$1.3 billion). We selected our sample from the latest 15 months because supporting documentation was not readily available for older assets and the FAP was implemented in April 1995. The 416 items selected for review were in two strata. The first stratum consisted of all items (16) that had acquisition values greater than \$10 million; these items totaled \$617.8 million. The second stratum consisted of a statistical sample of 400 items selected from all items, each valued \$10 million or less; these items totaled \$84.9 million.

For the 416 items, we sent a questionnaire to 170 VA activities which included VAMCs, regional offices, cemeteries, and other 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 test the accuracy of financial data for sampled real property items. In addition, we reviewed the monthly reconciliation of real property for the fourth quarter of FY 1996 and analyzed year-end WIP account balances.

RESULTS OF AUDIT TESTS

Controls Need Strengthening to Ensure the Accuracy of Financial Data for Real Property

Our review of 416 real property items showed that the accuracy of data recorded in the FAP needed improvement. We noted deficiencies for 190 of the 416 items reviewed. For 158 items reviewed, we found one or more errors in the recorded acquisition value, acquisition date, or useful life of the asset. For 20 items reviewed, there was insufficient documentation to substantiate the data recorded in the FAP. For 12 other items reviewed, no costs were recorded in the FAP. The net impact of the exceptions were:

- For 16 high-dollar items, the net impact of the errors overstated the building account by \$31.3 million; understated the construction WIP account by \$29.7 million; and, overstated the FY 1996 depreciation expense account by \$1.1 million, and the prior years' depreciation by \$280,000.
- For the 400 statistically sampled items, the net impact of the errors understated the building account by \$123,000, the WIP account by \$1.1 million, the FY 1996 depreciation account by \$211,000, and the prior years' depreciation by \$492,000.
- Overall, the projected net impact of the results of the 400 sampled items, understated the building account by \$1.0 million, the WIP account by \$8.4 million, the FY 1996 depreciation account by \$1.6 million, and the prior years' depreciation by \$3.8 million.

Recording Errors One hundred fifty-eight of the real property items reviewed had one or more errors in the recorded acquisition cost, acquisition date, or useful life, of the asset, as presented below:

Acquisition Cost Errors Seventy of the 158 real property items had errors in the acquisition cost that either overstated or understated the building asset account. Incorrect costs were inputted primarily because of (1) administrative input errors; (2) improper capitalization of buildings under construction, recurring repair and maintenance costs, asbestos removal costs, and A&E costs of canceled projects; (3) partial capitalization of completed projects; and, (4) improper expensing of installation costs and A&E costs. Examples are:

- VAMC staff inputted \$28.6 million instead of \$26.7 million in the FAP, resulting in overstating the building asset account by \$1.9 million and the related depreciation accounts by \$42,200.
- VAMC staff improperly capitalized buildings totaling \$29.8 million before the buildings were completed and placed into service (instead of recording the costs incurred into the WIP account). This occurred because Fiscal Service staff used an incorrect Budget Object Code which resulted in partial payments being charged directly to the building general ledger account (1730). As a result, the building account and related depreciation accounts were overstated by \$29.8 million and \$1.3 million, respectively. In contrast, a different VAMC partially capitalized (\$55,476) the cost of a completed building project, instead of capitalizing the entire project cost (\$488,104). This resulted in understating the building account and related depreciation accounts by \$432,628 and \$43,263, respectively.
- VAMC staff erroneously capitalized \$126,796 repair and maintenance costs instead of expensing them in the period they were incurred. Therefore, the building account was overstated and expense account was understated by \$126,796.
- VAMC staff incorrectly capitalized asbestos removal costs totaling \$42,137. This resulted in overstating the building account and understating the expense account by \$42,137.
- VAMC staff incorrectly capitalized \$39,600 of A&E costs for a project that was canceled. When the project was canceled, the \$39,600 should have been taken out of the WIP account and expensed. This resulted in overstating the building and related depreciation accounts. On the other hand, staff at another VAMC improperly expensed \$98,600 of A&E costs for a project that had been completed. The \$98,600 should have been capitalized as part of the completed project. This resulted in understating the building account and the related depreciation accounts.
- VAMC staff improperly expensed \$150,000 of installation costs instead of capitalizing the cost as part of the completed construction project. This resulted in understating the building account and the related depreciation accounts.

Acquisition Date Errors One hundred six of the 158 real property items had errors in the acquisition date, which should be the date the asset is put into service. Fiscal staff recorded into the FAP incorrect acquisition dates such as the final

progress payment date, Engineering Service capitalization memorandum date, journal voucher date, last activity date, or purchase order date. This occurred primarily because Engineering Service staff did not include acquisition date in its capitalization memorandum and Fiscal Service staff arbitrarily assigned an acquisition date. For example:

- VAMC staff used the last activity date of August 30, 1995 as the acquisition date, instead of July 1, 1992 which was the date the asset (\$655,299) was placed in service. As a result, depreciation did not start until 38 months after the asset was placed in service. This understated depreciation expense and accumulated depreciation by \$51,840.
- VAMC staff incorrectly recorded September 21, 1995 as the acquisition date, instead of April 23, 1996, which was the date the asset (\$188,067) was placed in service. Therefore, depreciation expense was started 7 months too early, which overstated depreciation expense and accumulated depreciation by \$5,513.
- VAMC staff incorrectly recorded March 31, 1996 (final progress payment date) as the acquisition date although the project (\$246,561) was placed in service in July 1994. This resulted in depreciation being started 20 months late, which understated depreciation expense and accumulated depreciation by \$20,441.

Useful Life Errors Fifty-four of the 158 real property items had errors in the depreciable life of the real property items reviewed. Assignment of inappropriate useful lives to buildings resulted in either understating or overstating depreciation expense and the related depreciation accounts. For example, a VAMC incorrectly assigned a 25-year life to an asset totaling \$218,500; however, the correct useful life was 40 years (a difference of 15 years). This resulted in overstating depreciation expense and the related depreciation accounts by \$3,563. Conversely, another VAMC overestimated the useful life of an asset totaling \$217,255 by 20 years (the correct estimated useful life was 20 instead of the 40 years used). This resulted in understating depreciation expenses and the related depreciation accounts by \$6,785.

Insufficient Documentation We were unable to obtain sufficient supporting documentation for 20 (\$31.3 million) of the real property items reviewed. At one VAMC, sufficient documentation (such as purchase orders or contracting documents) were not available to support two buildings costing \$28.5 million. Staff at another VAMC incorrectly recorded the value of all construction progress payments made in a month as one asset, and called the asset “improvement.” They

should have recorded each construction project as a separate asset, since each project had different acquisition costs, acquisition dates, and useful lives. As a result, there was no assurance that the data in the FAP for the acquisition value and date and the estimated useful lives of the 20 items were accurate.

Items with No Cost Twelve of the items reviewed had no cost recorded in the FAP. These items resulted primarily from posting errors. The items were not assets and should be deleted from the FAP.

Better Management of WIP Accounts Would Ensure Timely Capitalization of Assets Placed In Service

At 28 of the 45 VAMCs reviewed, the FY 1996 year-end WIP accounts contained errors. We found that buildings valued at \$37.6 million were in use but had not been capitalized; and another \$4.0 million (related to A&E costs of canceled projects, service contracts, and asbestos removal costs) needed to be expensed. Of the \$37.6 million, \$26.7 million was still in the construction WIP account as of September 30, 1996; the remaining \$10.9 million was erroneously written off during reconciliations. As a result, the WIP account was overstated \$30.7 million; the building account was understated by \$37.6 million and the related depreciation accounts were understated \$1.4 million. Examples are:

- At one VAMC, nine building projects totaling \$2.6 million were completed and placed in service during FYs 1993 to 1996. However, these nine projects had not been capitalized as of the end of FY 1996.
- At another VAMC, facility staff improperly reduced \$438,204 of WIP costs by the estimated value of the old assets being replaced (\$286,072) and installation costs (\$197,132).

Improved management control is needed over the construction WIP to ensure timely capitalization of assets and the accuracy of the WIP account. The conditions discussed above occurred because of insufficient coordination between Engineering and Fiscal Services. To facilitate timely capitalization of assets, Engineering Service needs to inform Fiscal Service of (1) the date each project was completed and placed in service; (2) projects that have been canceled; and, (3) assets that have been disposed of so that Fiscal Service can make adjustments to the appropriate asset and depreciation accounts.

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

About 29 percent (13 of the 45) of the VAMCs reviewed did not perform monthly reconciliations of real property accounts as required. For example, facility staff did not complete one or more of the required monthly reconciliations of building accounts during the fourth quarter of FY 1996. Also, staff at 13 VAMCs had not completely reconciled data converted from the old manual property cards to the new FAP system. When balances did not reconcile, staff at 14 VAMCs said that, due to lack of time for adequate research, they made unsupported adjustments to the building accounts. For example, one facility reduced the fixed asset accounts by \$44 million, but documentation to support this adjustment was not available; staff at another facility could not explain \$13.7 million of adjustments.

Complete reconciliations each month would help identify and resolve variances before they become major problems.

CONCLUSION

Much progress has been made in improving real property tracking systems and correcting building 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 a future qualification of VA's CFS. Accordingly, we encourage financial managers to increase efforts to perform financial reconciliations and analytical reviews of real property general ledger and FAP data and provide additional guidance and training to accounting staff involved in processing real property transactions, accounting entries and performing reconciliations 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, and useful life for real property) is accurately inputted into the FAP.
- Fiscal staff select correct Budget Object Codes to prevent erroneous recording of on-going projects as assets before construction is completed.
- Engineering and Fiscal Service improve the coordination and exchange of information regarding: (1) the dates buildings or improvements are placed in service; (2) the description of old assets that have been retired or disposed of so they can be removed from the general ledger accounts and the FAP; (3) project costs that need to be capitalized including A&E and installation costs; and, (4)

project costs that need to be expensed, such as asbestos removal costs, repair and maintenance costs, etc.

- Supporting documentation (e.g., purchase orders/contracts, vendor's invoices, receiving reports, work orders, engineer reports, etc.) is maintained for real property in accordance with VA policies.
- Fiscal staff review and reconcile FMS-generated monthly WIP reports and coordinate with Engineering staff to ensure timely capitalization and/or expensing of costs as appropriate.
- Fiscal staff reconcile and adjusts general ledger accounts and FAP data at least monthly.
- Adjustments made to the building accounts are fully supported.