



Office of Inspector General

MANAGEMENT LETTER: ACCURACY OF FISCAL YEAR 1998 PROPERTY, PLANT, AND EQUIPMENT FINANCIAL INFORMATION

*VA needs to increase management oversight
and enhance controls to improve the
accuracy of financial information.*

**Report No. 9AF-G10-066
Date: March 26, 1999**

Office of Inspector General
Washington DC 20420



DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

March 26, 1999

Memorandum to:

Deputy Assistant Secretary for Finance (047)

Chief Financial Officer, Veterans Health Administration (17)

**Management Letter: Accuracy of Fiscal Year 1998 Property, Plant, and
Equipment Financial Information, Report No. 9AF-G10-066**

1. As part of our audit of the Department of Veterans Affairs (VA) Consolidated Financial Statements (CFS) for Fiscal Year (FY) 1998, we assessed the accuracy of property, plant, and equipment (PP&E) account balances and evaluated internal accounting controls over PP&E. In addition, we analyzed PP&E data in the general ledger and fixed asset subsystem, and actions taken by the VA and Veterans Health Administration (VHA) staff to improve internal controls.
2. As of September 30, 1998, VA had over 202,000 PP&E items totaling \$19.1 billion with accumulated depreciation of \$8.2 billion. About \$18.4 billion (96.6 percent) of the PP&E items were at VHA facilities. The rest of the PP&E items were held by the Veterans Benefits Administration, National Cemetery Administration, and Central Office. To assess the accuracy and reliability of financial information in VA's FY 1998 CFS, we evaluated the accuracy and reasonableness of PP&E and related depreciation account balances and the adequacy of key internal controls over real property and equipment items. Specifically, we discussed PP&E accounting policies with appropriate VA Central Office staff, analyzed national PP&E general ledger account data, and reviewed a national sample of 395 PP&E items. Since VHA facilities had most of the PP&E items, we visited 16 medical facilities, and sent questionnaires to 22 medical facilities. We also evaluated VA's implementation of new reporting requirements for heritage assets, clean-up costs, and deferred maintenance costs.
3. Our prior audits identified problems with the systems, processes, and procedures used to control PP&E items. These audits also identified a number of errors in PP&E account balances and related subsidiary records. In response to our prior audit findings, VA financial managers have increased oversight of PP&E account balances, provided additional guidance to facility staff, and conducted special reviews of high-value PP&E

items. For example, during May 1998, VHA had medical facilities (a) review all PP&E items that had acquisition values of \$750,000 or greater, and (b) certify to the accuracy of information recorded in the fixed asset subsidiary records for these high-value items.

4. Although some improvements have been made in the accuracy of PP&E financial information, our FY 1998 audit disclosed a number of errors and internal control weaknesses concerning real property and equipment. None of these issues had a material effect on VA's financial statements based on tests made. However, we are providing you our findings to emphasize the continuing need to enhance internal controls and improve operations. VA financial managers need to continue efforts to ensure that facility staff:

- Record acquisition costs, receipt/placed in service dates, and useful lives of real property and equipment items accurately in the financial records.
- Complete monthly reconciliations of real property and equipment general ledger accounts, and make any appropriate adjustments timely.
- Capitalize costs in the construction work-in-process accounts when the building or building improvement is placed into service.
- Complete physical inventories of nonexpendable equipment on schedule.
- Implement reporting requirements for heritage assets, clean-up costs, and deferred maintenance costs.

5. Details of our observations are discussed in Appendix II of this report. In our opinion, the types of errors noted during the audit could result in a future material weakness if they are not corrected. During the audit, we provided VHA and VA Central Office staff with interim audit results so they could implement appropriate corrective actions. On February 3, 1999, we discussed our audit results with VHA and VA Central Office staff.

6. You are not required to provide an official response to this management letter. However, we would appreciate receiving any written comments you wish to make. We will continue to monitor and follow-up on the issues in this report during future financial statement audits.

7. We are available to provide assistance to your staff on these issues. If you wish to discuss this report or need additional information, please contact Mr. Jack Shigetomi at (310) 268-4336, or me at (202) 565-7013.

For the Assistant Inspector General for Auditing

(Original signed by:)

John E. Jonson
Director, Financial Statements Audit
Operations Division (52CF)

TABLE OF CONTENTS

Memorandum to:	<u>Page</u>
Deputy Assistant Secretary for Finance (047)	
Chief Financial Officer, Veterans Health Administration (17)	i
APPENDICES	
I. PURPOSE, BACKGROUND, AND SCOPE	1
II. DETAILS OF AUDIT	6
A. Continuing Oversight Is Needed to Refine Property, Plant, and Equipment Records	6
B. Action Is Needed to Improve the Accuracy of Real Property and Nonexpendable Equipment Information	8
C. Increased Emphasis Is Needed to Ensure that Account Reconciliations Are Performed Monthly	11
D. Better Management of the Work-in-Process Account Would Ensure Timely Capitalization of Assets Placed in Service	12
E. Improvements Are Needed to Ensure Accurate and Timely Physical Inventories of Nonexpendable Equipment	13
F. Controls are Needed over Reporting of Heritage Assets, Clean-up Costs and Deferred Maintenance Costs	14
G. Conclusion – Increased Emphasis Is Needed in the Areas of Management Oversight and Internal Controls Implementation	16
III. FACILITIES VISITED	19
IV. FINAL REPORT DISTRIBUTION	20

PURPOSE, BACKGROUND, AND SCOPE

PURPOSE

As part of our audit of the Department of Veterans Affairs (VA) Consolidated Financial Statements (CFS) for Fiscal Year (FY) 1998, we assessed the accuracy of property, plant, and equipment (PP&E) account balances and evaluated internal accounting controls over PP&E. We also performed the level of work required by Office of Management and Budget Bulletin No. 98-08, as amended, on deferred maintenance and the Required Supplementary Stewardship Information (RSSI) for FY 1998.

Our prior financial statement audits, for FYs 1992 through 1997, identified internal control problems, and significant errors in PP&E and related depreciation account balances. In response to our prior audits, VA initiated corrective actions, and continues to make progress in improving internal controls over PP&E and correcting account balances. The VA and Veterans Health Administration (VHA) Chief Financial Officer (CFO) staff have:

- Issued additional guidance and instructions.
- Performed analytical reviews of general ledger accounts to identify and correct accounting errors and irregular account balances.
- Worked with facilities to reconcile general ledger PP&E account balances to the subsidiary record balances.
- Requested VHA facilities to review and certify to the accuracy of information for fixed assets costing \$750,000 or more.

BACKGROUND

Definition of Property, Plant, and Equipment. During FY 1998, VA redefined PP&E as either general or heritage assets. General PP&E is divided into two basic groups. The first group consists of real property such as buildings, other structures, and land. The second group consists of nonexpendable equipment, including computer software. VA policies address real property and equipment separately, since fund sources and transaction processing are different. Heritage assets are unique because of their historical or natural significance; cultural, educational, or artistic importance; and/or significant architectural characteristics.

Chief Financial Officers Act. The CFO Act of 1990 (Public Law 101-576) requires VA to issue annual reports on its CFS. The Act also requires that the financial statements be audited each year to ensure financial data is accurate and reliable for use in making management decisions and improving accountability.

Financial System. The Financial Management System (FMS) is VA's core financial management system. FMS is a comprehensive, agency-wide system that supports a full range of financial activities. The system was designed to: (a) increase accounting controls, (b) enhance internal controls, (c) implement the Standard General Ledger, and (d) comply with the Joint Financial Management Improvement Program Core Financial Systems Requirements. In April 1995, VA facilities began installing the FMS Fixed Assets Package (FAP) for real property assets. The FAP contains detailed data (e.g., acquisition cost, receipt/placed in service date, and useful life) for each asset and computes depreciation for each item. In June 1996, facilities implemented the Automated Engineering Management System/Medical Equipment Reporting System, which contains data on equipment.

VA Policies. VA policies state that the accounting system should provide for effective internal controls. The internal control structure should provide reasonable assurance that: (a) accounting operations and transactions are in accordance with applicable laws, regulations, and agency policies; (b) assets are safeguarded against waste, loss, and unauthorized use; and (c) assets, expenditures, and revenues applicable to agency operations are properly recorded and accounted for to permit accurate and reliable financial reports.

Real Property Capitalization. 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. The useful life is the estimated years the asset is projected to be in service. 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 component costs are 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 (a) labor, material, and supply costs; (b) architectural and engineering costs; and (c) site preparation costs. The acquisition date should be the date that the asset was placed into service. This information is obtained from Engineering Service.

Real Property Records Retention. MP-4, Part X states Real Property Accounting Record (VA Form 4578) should be maintained for each Government-owned building, structure, facility, or land. This record should be maintained for the life of the asset, and should be

destroyed 3 fiscal years after disposition of the asset. Although this policy is posted on the Internet, it needs updating.

Construction Work-in-Process (WIP). Project costs related to buildings and structures under construction should be accumulated in the WIP account. Subsequently, costs in the WIP account should be capitalized in the asset accounts when the asset is placed in service. Moreover, project costs should be expensed if (a) the total cost does not meet the \$5,000 capitalization criteria, or (b) VA policy specifically excludes the costs from capitalization, such as costs for removing asbestos.

Equipment Capitalization. Nonexpendable equipment costing \$5,000 or more, and having a useful life of 2 years or more should be capitalized in the FAP. The acquisition costs should consist of: (a) all amounts paid to the vendor; (b) transportation charges; (c) handling and storage costs; and (d) 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 FAP automatically records each equipment item's useful life based on its category stock number.

Account Reconciliations. VA Directive 4520 requires that monthly reconciliations be accomplished to compare the balances in the general ledger accounts with the balances in the subsidiary records. These reconciliations are essential for ensuring the accuracy of the general ledger account balances.

Equipment Inventories. VA facilities are required to perform physical inventories of nonexpendable equipment and reconcile the inventory counts to accountable records. Facility staffs use the last inventory date and accuracy rate for each Equipment Inventory List¹ (EIL) 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.

Bar-coding Equipment. To better control equipment and facilitate the physical equipment inventory process, VA procured bar-coding equipment for medical facilities. The use of bar codes enables facility staff to quickly identify equipment items, reduces the time for conducting inventories, and increases inventory accuracy. These benefits are possible because facility staff do not have to manually verify and record equipment identification numbers.

¹ A list of equipment items that belong to an activity or section within a facility.

Policy for Heritage Assets, Clean-up Costs, and Deferred Maintenance. On April 20, 1998, the Office of Financial Policy issued Office of Financial Management (OFM) Bulletin 98GA1.4 that provided new accounting and reporting requirements for heritage assets, clean-up costs, and deferred maintenance costs. The bulletin sets forth the following requirements:

- **Heritage Assets.** Effective May 1, 1998, new obligations for the costs of acquisition, construction, renovation, and/or modification of heritage assets should be recorded as a current period operating expense.
- **Clean-up Costs.** On or before June 30, 1998, VA stations should record a liability for the estimated cumulative clean-up liability for FY 1998. Each year thereafter, stations should recognize an estimated cumulative liability for clean-up costs for hazardous waste associated with VA assets. Clean-up costs may include decontamination, site remediation, site restoration, site monitoring, decommissioning, closure and post closure costs.
- **Deferred Maintenance Costs.** The Office of Management and Budget requires VA to present financial data for deferred maintenance starting in FY 1998. Deferred maintenance is defined as maintenance that was not performed when it should have been or was scheduled to be performed, but was put off or delayed for a future period. For reporting purposes, estimates of deferred maintenance can be aggregated from unfunded non-recurring maintenance projects. On or before June 30, 1998, stations should record in the general ledger for FY 1998 the estimated cumulative total of deferred maintenance projects for capitalized assets (buildings, other structures, and equipment). Similar entries should be recorded each year thereafter for deferred maintenance costs.

SCOPE

As of September 30, 1998, VA had over 202,000 PP&E items totaling \$19.1 billion and accumulated depreciation totaling \$8.2 billion. About \$18.4 billion (96.6 percent) of the PP&E items were at VHA facilities. The rest of the PP&E items were held by the Veterans Benefits Administration, National Cemetery Administration, and Central Office. To assess the accuracy and reliability of financial information in VA's FY 1998 CFS, we evaluated the accuracy and reasonableness of PP&E and related depreciation expense account balances, and the adequacy of key internal controls over real property and equipment. Specifically, we discussed PP&E accounting policies with appropriate VA Central Office staff, analyzed national PP&E general ledger account data, and reviewed a national sample of 395 PP&E items. Since VHA facilities had most of the PP&E items, we visited 16 medical facilities and sent questionnaires to 22 medical facilities. We also

evaluated VA's implementation of new reporting requirements for heritage assets, clean-up costs, and deferred maintenance costs.

Central Office Visits. We interviewed appropriate staff assigned to the VHA CFO and the Office of Deputy Assistant Secretary for Finance. We discussed financial policies, oversight of financial information, and actions taken to correct accounting errors identified during prior CFS audits.

Analyses of Financial Information. On a national basis, we analyzed PP&E (a) general ledger account balances to identify irregular balances, and (b) asset information recorded in the FAP to identify inaccurate transactions.

Questionnaires to Medical Facilities. We sent 22 medical facilities [one in each Veterans Integrated Service Network (VISN)] questionnaires on equipment inventories, real property and equipment account reconciliations, and the WIP account. As appropriate, we followed up on questionnaire responses with responsible facility staff.

Review of PP&E Items. We selected a national sample of 395 items (buildings and equipment) to test the accuracy of the data recorded in the FAP and to determine whether the items were on-hand. Our sample consisted of three strata. The first stratum consisted of all 125 assets that had an acquisition value of \$15 million and greater. The second stratum consisted of a sample of 132 items that had acquisition values of \$750,000 up to \$15 million. The third stratum consisted of 138 items that had acquisition values under \$750,000. For the 395 sample items, we sent questionnaires to the appropriate VA activities requesting them to provide documentation to verify the acquisition costs, date the asset was received or placed in service, useful life, and whether the item was on-hand.

VHA Facility Visits. During the internal control and testing phases of the audit, we visited 16 medical facilities to evaluate internal accounting controls for PP&E. The 16 facilities visited provided financial management support to 11 other medical facilities. (See Appendix III for a list of facilities visited.) We reviewed procedures concerning account reconciliations and equipment inventories, and verified the accuracy of PP&E data recorded in the general ledger and the FAP. We also followed up on questionnaires sent to the facilities.

The audit was conducted in accordance with generally accepted government auditing standards.

DETAILS OF AUDIT

A. Continuing Oversight Is Needed to Refine Property, Plant, and Equipment Records

Our analyses of the fixed asset general ledger and FAP data for FY 1998 disclosed improvement in the accuracy of financial data. However, our analyses noted a number of irregular account balances and accounting errors. In November 1998, we provided VHA CFO staff with the results of our analyses so they could initiate appropriate corrective actions. We urge VA financial managers to continue their oversight and review of PP&E financial data to refine the accuracy of PP&E general ledger accounts.

Analyses of General Ledger and FAP Information

General Ledger Accounts. We analyzed FY 1998 year-end trial balance data for PP&E assets and related accumulated depreciation accounts for all VA activities. We found that VA has made significant progress in reducing the number of PP&E accounts with irregular balances (i.e., normal debit accounts with credit ending balances and normal credit accounts with debit balances). For example, the number of normal debit accounts with credit balances decreased from 92 accounts in FY 1996 to just 20 accounts in FY 1998. It is important that these types of irregular account balances are corrected because they indicate that errors were made in recording and/or adjusting transactions in these accounts. The following table shows the number of irregular account balances noted at the end of FY 1998 versus FYs 1997 and 1996.

Irregular Account Balance	FY 1998	FY 1997	FY 1996
Normal Debit Accounts with Credit Ending Balances			
Number of Accounts	20	48	92
Dollar Amount (millions)	\$2.40	\$4.68	\$92.17
Normal Credit Accounts with Debit Ending Balances			
Number of Accounts	5	4	46
Dollar Amount (millions)	\$.05	\$.17	\$14.63

Normal Debit Accounts with Credit Ending Balances. The 20 irregular account balances involved asset (buildings, equipment, etc.) accounts with credit balances, at the end of FY

1998, which should have been debits. For these accounts, the credit balances totaled \$2.4 million indicating an understatement of the assets by this amount or more.

Normal Credit Accounts with Debit Ending Balances. The five irregular account balances involved accumulated depreciation accounts with debit balances at the end of FY 1998, which should have been credits. For these accounts, the debit balances totaled \$50,000, indicating an overstatement of assets and an understatement of accumulated depreciation by this amount or more.

FAP Information. Our analyses of data recorded in the FAP as of September 30, 1998, disclosed that, for the most part, the number of errors and/or indicators of problems decreased from those noted in FY 1997 and FY 1996. One area that needed additional management attention is the incorrect capitalization of nonexpendable equipment items costing less than \$5,000. Details of our analyses are discussed below:

- For FY 1998, no accumulated depreciation was recorded in the FAP for 487 building and equipment items (costing \$40.4 million) acquired before September 1, 1998,² for which depreciation should have started. Of the 487 items, no accumulated depreciation was recorded because 82 items had no useful life recorded in the FAP, 253 items had no acquisition cost recorded in the FAP, and 4 items had neither useful life nor acquisition cost recorded in the FAP. The remaining 148 items had all three elements (date received or placed in service, useful life, and acquisition cost) recorded in the FAP. We found that 2 of the 148 items were placed on the FAP on October 2, 1998 although the items were received in 1997. Therefore, the error was caused by a timing difference in recording the assets in the FAP. These errors resulted in understating the accumulated depreciation and overstating net asset values. The number of FY 1998 exceptions (487) decreased from 1,743 (\$108 million) noted at the end of FY 1997 and 1,610 noted at the end of FY 1996.
- At the end of FY 1998, 68 building and equipment items incorrectly had a book value totaling \$12.6 million, which should have been zero because their designated useful lives had expired. As a result, the net asset values were overstated and the related depreciation expense and accumulated depreciation accounts were understated. The number of FY 1998 exceptions (68) decreased from 1,680 (\$180.3 million) noted at the end of FY 1997 and 2,639 noted at the end of FY 1996.
- At the end of FY 1998, 18 building and equipment items (\$3.1 million) incorrectly had acquisition dates in the future; therefore, depreciation was not started. As a result,

² As depreciation begins 30 days after being acquired, assets acquired after September 1, 1998 should have had depreciation recorded effective October 1, 1998.

assets were overstated and the related depreciation expense and accumulated depreciation were understated. The number of FY 1998 exceptions decreased from 22 noted at the end of FY 1997 and 204 noted at the end of FY 1996.

- At the end of FY 1998, 3,021 equipment items (\$4.6 million) with acquisition values of under \$5,000 each were incorrectly recorded in the FAP. In addition, 201 other equipment items were shown as having no acquisition value. None of these items should have been capitalized under VA capitalization policy, which states that items under \$5,000 should be expensed. As a result, the equipment account balance was overstated by \$4.6 million. The number of FY 1998 exceptions increased from 2,532 (\$4.3 million) noted at the end of FY 1997 and 1,377 (\$2.4 million) noted at the end of FY 1996.

To improve the accuracy of PP&E financial information, VHA CFO staff should continue oversight of PP&E accounting activities. Specifically, they should (i) analyze PP&E general ledger account and FAP data to identify errors and unusual account balances, and (ii) report any errors or unusual account balances to the appropriate Veterans Integrated Services Network or facility director so that corrective actions can be accomplished. In addition, VHA CFO staff should coordinate with VA Office of Finance staff to investigate and correct potential FMS problems concerning asset depreciation.

B. Action Is Needed to Improve the Accuracy of Real Property and Nonexpendable Equipment Information

Fixed Asset Sample. As of September 30, 1998, VA activities had over 202,000 fixed assets. The acquisition value for these assets totaled \$19.1 billion and their book value totaled \$10.9 billion. From this universe, we selected a sample of 395 PP&E items to test the accuracy of the data recorded in the FAP and to determine whether the items were on-hand. For the 395 sample items, we sent questionnaires to the appropriate VA activities requesting them to provide us supporting documentation that verified the acquisition costs, date the asset was received or placed in service, useful life, and whether the item was on-hand. We also visited medical facilities and followed up with other activities, when appropriate.

Sample Review Results. Our review showed that the accuracy of data recorded in the FAP needed improvement. We noted deficiencies for 58³ of the 395 items reviewed. Specifically, 21 items had incorrect acquisition costs, 28 items had incorrect receipt or placed in service dates, 10 items had incorrect useful lives, and 6 items could not be located. The overall projected net impact of the deficiencies found is: (a) an

³ Some items had more than one deficiency.

overstatement of \$80.5 million in the asset accounts and (b) understatement of \$5.6 million in the accumulated depreciation accounts. The following are examples of the deficiencies found for real property and equipment items.

Real Property

- Facility staff erroneously capitalized \$22,941,606 for a Spinal Cord Injury Unit Addition in the FAP. The correct project cost was \$21,036,000. This error overstated the building account by \$1,905,606; the prior year depreciation by \$524,042; FY 1998 depreciation by \$47,640; and the accumulated depreciation by \$571,682.
- Facility staff did not timely remove from the FAP private room toilets (acquisition cost of \$56,186) that were scrapped when wards were renovated in 1980. As a result, these items incorrectly remained in the FAP as of September 30, 1998, causing the building account to be overstated by \$56,186 and the accumulated depreciation account to be overstated by \$50,325.
- Facility staff incorrectly assigned a 40-year useful life for an asset costing \$1,606,744. During our audit, facility staff reported that the correct useful life for this item was 20 years. As a result, the prior year depreciation was understated by \$508,235; FY 1998 depreciation was understated by \$40,168; and accumulated depreciation was understated by \$548,403.
- Facility staff incorrectly recorded on the FAP a 100-year useful life for a clinical addition building costing \$88,049,921. During our audit, facility staff reported that the correct useful life for this asset was 40 years. This error understated both FY 1998 depreciation and accumulated depreciation by \$349,593 each as of September 30, 1998. In FY 1999, facility staff corrected the useful life for this asset.

Equipment

- Facility staff incorrectly recorded in the FAP an acquisition cost of \$1,432,064 for a Linear Accelerator. This amount was the total cost for two High Energy Linear Accelerators and a Radiotherapy Simulator. These items were incorrectly recorded in the FAP as the transaction was a sharing agreement purchase with a private medical facility where the equipment is located and the VA portion was one of the Linear Accelerators (acquisition cost of \$650,938). The error overstated both the equipment account and accumulated depreciation by \$781,126 each.

- Facility staff incorrectly recorded in the FAP an acquisition cost of \$5,300 for an asset that actually cost \$67,720. This error understated the equipment account by \$62,420 and understated accumulated depreciation by \$31,210.
- Facility staff incorrectly recorded in the FAP an acquisition cost of \$67,830 for a Nova 16 Analyzer/w printer that actually cost only \$22,000. This error overstated the equipment account by \$45,830 and the accumulated depreciation by \$5,566.
- Facility staff incorrectly recorded in the FAP a receipt date of January 27, 1997, for a Telephone System costing \$1,969,602. However, the memorandum from the Chief, Engineering Service, stated that the system was completed on August 1, 1996. The receipt date recorded in the FAP was the date for another purchase order for telephones and speakerphones. Therefore, depreciation was started approximately 6 months late. This error resulted in understating both accumulated depreciation and prior year depreciation expense by \$54,712 each.
- Facility staff erroneously capitalized a \$365 vacuum unit. This item should have been expensed because it did not meet the VA capitalization criteria of \$5,000. As a result, the equipment account was overstated by \$365.

In view of the above errors, we believe that VA and VHA CFO staff need to continue working with facilities to ensure that fixed asset data are correctly recorded in the FAP. Also, we believe VHA CFO staff needs to continue their emphasis on the accuracy of data for high-dollar value building and equipment items.

Documentation

Documentation supporting PP&E items needed improvement. Documentation was not readily available, or had not been retained, to support the acquisition cost and other attributes of many PP&E items. In some cases, the records retention period prescribed in VA policy had expired. In other cases, documentation could not be readily found. We believe that VA needs to update the criteria on maintaining documentation for PP&E. The revised criteria should require facilities to maintain a readily available manual or computerized permanent file containing basic documentation that supports the cost of each asset, the date the asset was received or placed in service, the useful life, and any subsequent acquisition (addition or betterment) affecting the recorded value of the item.

C. Increased Emphasis Is Needed to Ensure that Account Reconciliations Are Performed Monthly

We sent questionnaires to 22 medical facilities (one from each VISN) to determine whether they completed the required monthly reconciliations of general ledger asset account balances with subsidiary record balances during FY 1998. We found that some facilities did not complete the reconciliations. The major reasons cited for not completing account reconciliations were staffing problems, and the integration and consolidation of facilities. Completion of monthly and year-end account reconciliations has been a problem noted in prior CFS audit reports. On November 10, 1998, we provided VHA CFO staff with the interim results of our analysis of the account reconciliation questionnaires. Details of our results for equipment and real property reconciliations are discussed below:

Equipment. Four (18.2 percent) of the 22 facilities did not complete some of their required monthly equipment account reconciliations during FY 1998. Three of the four facilities did not complete reconciliations for September 1998. Moreover, 11 (50 percent) of the 22 facilities did not complete the September 1998 reconciliations of equipment accounts in time for adjustments to have been included in the FY 1998 year-end trial balance. Timely reconciliations are essential to ensure the accuracy of financial information. Historically, reconciliation of equipment accounts has been a problem. In FY 1997 and FY 1996, we found that 11 and 20 percent, respectively, of the facilities reviewed had not completed all monthly reconciliations.

Real Property. Three (13.6 percent) of the 22 facilities did not complete some of their required monthly real property account reconciliations during FY 1998. One of the three facilities had not performed any reconciliations during the fiscal year, and the other two facilities did not complete reconciliations for September 1998. Historically, reconciliation of real property accounts has been a problem. In FY 1997 and FY 1996, we found that 17 and 29 percent, respectively, of the facilities reviewed had not completed all monthly reconciliations.

VA and VHA CFO staff should continue working with the facilities to ensure that monthly account reconciliations are completed as required, and proper adjustments are made timely. Completing monthly account reconciliations would identify variances and enable facility staff to make corrections before major problems occur.

D. Better Management of the Work-In-Process Account Would Ensure Timely Capitalization of Assets Placed In Service

Improved management controls are needed to ensure timely capitalization of assets and the accuracy of the WIP account. We sent questionnaires to 22 medical facilities to determine whether costs related to completed projects in the WIP account were capitalized in a timely manner. Ten of the 22 (45.5 percent) responded that all completed construction projects were not capitalized as of September 30, 1998. Since the questionnaires were sent to one medical facility in each of the 22 VISNs, the problems with timely capitalization of WIP costs occurred throughout VHA. Two of the ten facilities were unable to provide data on the number of projects and amounts that should have been capitalized or expensed. At the other eight facilities, the costs of the completed projects that were not capitalized totaled in excess of \$2 million. Additionally, more than \$109,000 in the WIP accounts should have been expensed. As a result, the asset account was understated by in excess of \$2 million, and expenses were understated by over \$109,000. For example:

- At one facility, Engineering Service personnel identified 18 projects as completed and placed in use prior to September 30, 1998. However, Engineering Service had not notified Financial Management Service that these projects totaling \$1,745,370 were completed and were to be capitalized for FY 1998. Consequently, real property asset accounts were understated by this amount and related depreciation expense accounts were also understated.
- At another facility, a project completed during FY 1998 was overlooked for capitalization purposes. Consequently, the estimated project cost of \$577,618 (\$572,618 to be capitalized and \$5,000 to be expensed) remained in the WIP account as of September 30, 1998.

The conditions discussed above occurred primarily because of inadequate coordination between Engineering and Financial Management Services concerning completed projects. Our prior CFS reports discussed similar deficiencies concerning timely capitalization of costs in the WIP account for completed projects.

To facilitate timely capitalization of assets, Engineering Service needs to inform Financial Management Service of: (a) the date each project is completed and placed in service as soon as the event occurs; (b) projects that have been canceled; and (c) assets that have been disposed of so that Financial Management Service staff can timely adjust the appropriate asset and accumulated depreciation accounts. In this regard, Engineering Service should work with Financial Management Service to establish a procedure for

communicating information on completed projects, such as preparing memorandums or sending E-mail messages for capitalization purposes.

E. Improvements Are Needed to Ensure Accurate and Timely Physical Inventories of Nonexpendable Equipment

We sent questionnaires to 22 medical facilities to determine whether required equipment inventories for items over \$5,000 were performed. We found that equipment items were not always inventoried on time. In addition, most of the facilities did not use bar-coding equipment to inventory nonexpendable equipment. On November 10, 1998, we provided VHA CFO staff with the interim results of our analysis of the equipment inventory questionnaires. Details of our results are discussed below:

Equipment Inventories Were Not Performed On Time. Thirteen of the 22 facilities (59.1 percent) did not complete from 1 to 227 required physical inventories that should have been performed during FY 1998. The asset value of items that were not inventoried in FY 1998 totaled \$222.5 million, or about 22.3 percent of all equipment items at the 22 facilities. The major reasons cited for delinquent equipment inventories were staffing problems and changes due to consolidation, reorganization, and restructuring at the facilities. Historically, timely completion of equipment inventories has been a problem. For FY 1997 and FY 1996 we found that 41 percent and 57.8 percent, respectively, of the facilities reviewed had not conducted one or more scheduled inventories that should have been performed. The value of the items not inventoried for FY 1997 and FY 1996 represented 15 percent and 18 percent, respectively, of the value of equipment at the facilities reviewed.

Bar-coding Systems Were Not Used to Inventory Equipment. Fourteen (63.6 percent) of the 22 facilities had bar-coded nonexpendable equipment. However, only 6 (27.3 percent) of the 22 facilities used the bar-coding system to conduct all equipment inventories during FY 1998. Historically, implementation of the bar-coding system has been a problem. Our FY 1997 and FY 1996 audits found that about half of the facilities visited had not implemented the bar-coding system and the major reason cited for not using the bar-coding system was equipment/software problems. The reasons cited in FY 1998 included staffing problems, bar coding of equipment not completed, and scanner problems. Timely and accurate inventories are essential to ensure that equipment is accounted for and adequately safeguarded, and missing items are detected timely. We believe that greater use of the bar-coding equipment would improve equipment identification, facilitate conducting the equipment inventories, and improve the accuracy of the inventories because facility staff do not have to manually verify equipment identification numbers.

F. Controls Are Needed over Reporting of Heritage Assets, Clean-up Costs and Deferred Maintenance Costs

Heritage Assets. We found that 4 of the 16 medical facilities reviewed had not implemented the new reporting requirements for heritage assets. The reason cited was that they did not receive VA's "Inventory of Historic and Cultural Resources" list provided by the Office of Facilities Management. Each facility was required to review heritage assets identified on the list for their station; report any modifications, corrections or deletions, especially building usage and building dates for heritage assets; and submit the facility's Cultural Resource Management/Historic Preservation contact to the Office of Facilities Management by June 30, 1998.

The RSSI section in VA's Consolidated Financial Statements for FY 1998 shows the following amounts for Heritage Assets:

Art Collections	16
Buildings and Structures	1,655
Monuments/Historic Flag Poles	60
Cemeteries	<u>91</u>
Total	<u>1,822</u>

We discussed the reported heritage asset totals with the VA Historic Preservation Officer (HPO). According to the HPO, the heritage asset amounts reported on the RSSI for FY 1998 were her best estimates based on her personal knowledge and the Inventory of Heritage Assets listing. We could not trace the RSSI reported amounts for the 1,655 buildings and structures and 60 monuments/historic flagpoles to the Inventory of Heritage Assets listing. We were able to trace the 16 art collections and the 91 cemeteries to the listing. However, the HPO stated that she could not attest to the accuracy of items listed on the Inventory of Heritage Assets listing because all pertinent supporting records were not available to her. In addition, the listing needs updating. We observed that the HPO had a number of corrections awaiting input into the Heritage Assets database. She anticipates revised reporting amounts for FY 1999 based on the revised database and responses from the facilities that may or may not have been included for the FY 1998 report.

To ensure that the Inventory of Heritage Assets listing is accurate, VA Central Office (VACO) management needs to place increased emphasis on updating the Heritage Assets database prior to the end of FY 1999. Facilities that have made changes to the current Inventory of Heritage Assets listing need to report those changes to the HPO as they

occur. We anticipate additional audit work in Heritage Assets for FY 1999, including review during our site visits to medical facilities.

Clean-up and Deferred Maintenance Costs. Some facilities had not implemented the requirement for identifying and reporting hazardous waste clean-up and deferred maintenance costs. As of September 30, 1998, clean-up costs recorded in the general ledger totaled \$139.4 million and deferred maintenance totaled \$622.9 million, of which deferred maintenance for buildings was \$439.7 million. Our analysis showed that 49 facilities did not record any clean-up and deferred maintenance costs as of September 30, 1998. We visited 7 of the 49 facilities and found that staff at 6 facilities had not implemented the accounting and reporting requirements for clean-up and deferred maintenance costs. For example:

- Facility staff did not have OFM Bulletin 98GA1.4 at the time of our visit. After we advised facility staff of the clean-up and deferred maintenance criteria, Engineering Service staff determined that deferred maintenance costs estimated at \$2.9 million should have been reported for FY 1998.
- Engineering staff had reported no clean-up or deferred maintenance costs for FY 1998. However, after we clarified the definition of deferred maintenance, Engineering staff identified 7 unfunded projects totaling \$1.2 million that should have been reported for FY 1998.
- Engineering staffs were unaware of this reporting requirement at three facilities.
- Procedures were not in place to estimate clean-up and deferred maintenance costs.

On October 30, 1998, we provided VHA and VACO staff with our analysis of clean-up and deferred maintenance costs. Based on our review, VACO staff needed to strengthen controls over the reporting of heritage assets, clean-up and deferred maintenance costs. They sent out implementation instructions and messages advising stations to implement the procedures, and asked for feedback. However, they did not follow through to assess actions taken by the facilities to identify and report heritage assets, and clean up and deferred maintenance costs. VACO staff should develop a method to track and monitor the required reporting.

G. Conclusion - Increased Emphasis Is Needed in the Areas of Management Oversight and Internal Controls Implementation

We found that VA has made good progress in improving internal controls over PP&E and correcting account balances. However, accounting errors and internal control problems still existed which, if not corrected, may result in a material weakness in the future. Accordingly, we encourage VA and VHA CFO staff to continue their efforts to provide additional written instructions and training to field staff, and emphasize the importance of financial account reconciliations, physical inventories, and analytical reviews of general ledger and FAP data. On February 3, 1999, we discussed with VHA CFO and VACO staff the deficiencies noted during the audit. We believe continued emphasis is needed in the following areas of management oversight and financial internal controls by field activities.

VHA and VACO Actions

VHA CFO and VA Office of Finance staff need to continue to:

- Provide management oversight of PP&E accounting activities.
- Report errors or irregularities noted during oversight reviews to the appropriate Veterans Integrated Services Network financial manager or activity director so that corrective actions can be accomplished.
- Provide guidance, instructions, and training to field staff.
- Analyze national general ledger and FAP data to identify potential errors and irregularities.
- Perform a special review of high-dollar value PP&E items similar to the reviews made in FY 1998. Have field staff research applicable supporting documents or make reasonable estimates to certify the accuracy of asset value and data recorded in the general ledger and the FAP.
- Update criteria to establish a requirement that facilities maintain a permanent folder or computerized file for the life of each asset that contains basic documentation supporting the cost of the asset, the date asset was received or placed in service, useful life, and subsequent acquisition (addition, betterment, etc.).
- Ensure that the Heritage Assets database and Inventory of Heritage Assets listing are updated prior to the end of FY 1999.

- Ensure that field staff notify the VA Historic Preservation Officer of any changes that require the updating of the Inventory of Heritage Assets listing.
- Provide guidance and ensure implementation of the requirements of VA Directive 7545, “Cultural Resource Management” covering Heritage Assets; and OFM Bulletin 98GA1.4, “PP&E Policy Update” covering Heritage Assets, Clean-up Costs, and Deferred Maintenance Costs.
- Develop a method to track and monitor the required reporting for clean-up and deferred maintenance costs for FY 1999.

Field Activity Actions

VA and VHA CFO staff should continue emphasizing to field activity staff to:

- Input fixed asset data (e.g., acquisition cost and date, and useful life) accurately into the FAP.
 - ◊ For equipment, acquisition values should include: (a) all amounts paid to the vendor; (b) transportation charges; (c) handling and storage costs; and (d) labor (including purchase and hire), materials, and supplies.
 - ◊ For real property, Engineering and Financial Management Services should coordinate and exchange information regarding: (a) the dates buildings or improvements are placed in service; (b) 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; (c) project costs that need to be capitalized including architectural and engineering and installation costs; and (d) project costs that need to be expensed, such as asbestos removal and repair and maintenance costs.
- Reconcile fixed asset general ledger account balances to subsidiary record balances at least monthly.
- Review and reconcile FMS-generated WIP monthly reports and coordinate with Engineering staff to ensure timely capitalization and/or expensing of project costs, as appropriate.
- Complete inventories for nonexpendable equipment on time by advising appropriate managers and employees to: (a) maintain a suspense file of EIL inventories; (b) follow-up on delinquent inventories; (c) notify the Facility Director of delinquent

inventories; and (d) require responsible officials to certify that the equipment inventories were conducted in accordance with applicable VA policies.

- Implement the bar-coding system for both tracking equipment and conducting physical inventories of equipment items.
- Establish controls to ensure that all facilities implement accounting and reporting requirements for heritage assets, clean-up costs and deferred maintenance costs for FY 1999.

FACILITIES VISITED

VAMC Atlanta, GA (508)
VA Maryland Health Care System (512/566/641)
VAMC Boston, MA (523/750)
VA Western New York Health Care System (528/513)
VA Chicago Health Care System (535/537)
VA North Texas Health Care System (549/522)
VA Greater Nebraska Health Care System (597/574)
VAMC Long Beach, CA (600)
VAMC Loma Linda, CA (605)
VA Northern Indiana Health Care System (610/569)
VAMC Memphis, TN (614)
VA Pittsburgh Health Care System (646/645)
VAMC San Francisco, CA (662)
VA Puget Sound Health Care System (663/505)
VAMC San Diego, CA (664)
VA South Texas Veterans Health Care System (671/591)

FINAL REPORT DISTRIBUTION

VA Distribution

Assistant Secretary for Financial Management (004)
Under Secretary for Health (105E)
Deputy Assistant Secretary for Finance (047)
Director, Management and Financial Reports Services (047GB)
Director, Accounting/Payroll Policy Service (047GA)
Chief Financial Officer, Veterans Health Administration (17)
Veterans Benefits Administration, Director, Office of Resource Management (24)
National Cemetery Administration, Director, Office of Operations Support (402)
Assistant Secretary for Congressional Affairs (009)
Deputy Assistant Secretary for Congressional Affairs (60)
Assistant Secretary for Public and Intergovernmental Affairs (002)
Deputy Assistant Secretary for Public Affairs (80)
Chief Network Officer (10N)
Director, Veterans Integrated Services Networks 1-22

Non-VA Distribution

General Accounting Office

Audit reports are available on the Office of Audit web site (<http://www.va.gov/oig/52/52-home.htm>). This report will remain on the web site for 2 fiscal years after its issue date.