Audit Report

OFFICE OF THE INSPECTOR GENERAL

NAVAL DESIGN ACTIVITIES MANAGEMENT OF JOINT LOGISTICS SYSTEMS CENTER ORDERS

Report No. 94-132 June 14, 1994

Department of Defense

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Acronyms

CNO	Chief of Naval Operations
JLSC	Joint Logistics Systems Center
NAS	Naval Audit Service
NCTC	Naval Computer and Telecommunications Command
NCTS	Naval Computer and Telecommunications Station

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

June 14, 1994

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)

SUBJECT: Naval Design Activities Management of Joint Logistics Systems Center Orders (Report No. 94-132)

We are providing this final report for your information and use. It discusses the naval design activities' continuing practice of incurring costs that exceed funding made available by customers. Comments on a draft of this report from the Commander, Naval Computer and Telecommunications Command, were considered in preparing the final report. As of the date of this memorandum, the Chief of Naval Operations had not responded to the draft report.

DoD Directive 7650.3 requires that audit recommendations be resolved promptly. Therefore, we request final comments on the recommendation by July 14, 1994. The comments must indicate concurrence or nonconcurrence with the finding and recommendation. The recommendation is subject to mediation in the event of nonconcurrence or failure to comment.

The courtesies extended to the staff are appreciated. If you have any questions concerning this audit, please contact Mr. Charles Hoeger, Audit Program Director, in our Philadelphia office at (215) 737-3881 (DSN 444-3881), or Mr. John Issel, Audit Project Manager, in our Columbus office at (614) 337-8009. The distribution of this report is in Appendix B. The audit team members are listed on the inside back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-132 **June 14, 1994**
(Project No. 2LD-2021.01)

NAVAL DESIGN ACTIVITIES MANAGEMENT OF JOINT LOGISTICS SYSTEMS CENTER ORDERS

EXECUTIVE SUMMARY

Introduction. This report addresses a cost overrun problem identified during our audit of the Joint Logistics Systems Center's Financial Statements for FY 1993 (Project No. 2LD-2021). The mission of the Joint Logistics Systems Center (JLSC) is to achieve corporate information management goals for the DoD logistics business areas of supply management and depot maintenance, by managing the design, development, and implementation of improved automated information systems. The JLSC issues reimbursable orders to DoD central design activities for the design and development of automated information systems.

Objective. The objective addressed in this report was to evaluate the adequacy of naval design activities' policy, procedures, and controls over funds provided to them on customer orders from the JLSC.

Results of Audit. Naval design activities performed work for customers that exceeded available customer funding, contrary to DoD and Navy regulations. The Naval Audit Service reported this condition in June 1987 and again in March 1992 (see Part I). Naval design activities of three major commands incurred overruns of about $1.6 million on JLSC orders.

Internal Controls. Our assessment of established internal controls showed that the Navy's financial accounting systems adequately disclosed the extent of cost overruns incurred by design activities.

Potential Benefits of Audit. This report identifies no quantifiable monetary benefits. However, appropriate management action against repeated violators of the prohibition on incurring customer order cost overruns should prevent recurrence of the situation, which results at best in the delayed receipt of revenues and could cause losses to be charged to Navy activities for work performed that was not funded.

Summary of Recommendation. We recommended that Navy management officials review cost overrun reports to determine the full extent of customer overruns at naval design activities and take appropriate action against personnel responsible for continued noncompliance with Navy direction.

Management Comments. The Commander, Naval Computer and Telecommunications Command, concurred with the draft report and stated that every effort will be made to strictly adhere to the Navy's cost overrun policy. The complete text of those comments is in Part IV. The Chief of Naval Operations, to whom the recommendation was addressed, did not respond to the draft report.

Audit Response. Comments from the Naval Computer and Telecommunications Command were responsive. However, the Chief of Naval Operations is requested to provide comments to the final report by July 14, 1994.

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This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

During our audit of the Joint Logistics Systems Center's (JLSC) Financial Statements for FY 1993 (Project No. 2LD-2021), we observed that naval design activities were incurring costs that exceeded funds made available by JLSC's reimbursable orders. JLSC is a corporate business area of the Defense Business Operations Fund established to manage the design, development, and implementation of improved automated information systems for the DoD logistics business areas of supply management and depot maintenance. The primary manner in which JLSC accomplishes its goals is through the issuance of reimbursable orders to DoD system design centers, such as naval design centers, for the design and development of automated information systems. Reimbursable orders are customer orders or work requests to perform certain tasks. They are the source of funds to pay for the work performed. The amount of funds made available by the reimbursable order is the maximum that has been approved for expenditure to perform the specified task or tasks of the order.

Objective

The objective addressed in this report was to evaluate the adequacy of naval design activities' policies, procedures, and controls over funds provided to them on customer orders by the JLSC.

Scope and Methodology

We evaluated internal policies and procedures that JLSC and naval design activities used to account for and control funds. We also reviewed JLSC, Naval Computer and Telecommunications Command (NCTC), Naval Sea Systems Command, Naval Supply Systems Command, and design activities' management reports and records covering the period September 29, 1992, through September 30, 1993. The management reports and records reviewed were generated from computer-processed data. The audit did not include a complete validation of the reliability of the computer-processed data because of the specialized nature of the audit. However, our assessment of the Navy's financial accounting systems showed that the systems adequately disclosed the extent of cost overruns incurred by design activities. We reviewed guidance issued by DoD; the Chief of Naval Operations (CNO); the Comptroller of the Navy; the Commander, NCTC; and JLSC on the control of obligations and expenditures of authorized funds.

This financial related audit was made from July through December 1993, in accordance with Office of Management and Budget Bulletin No. 93-06, "Audit Requirements for Federal Financial Statements," January 8, 1993, and auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. The organizations visited or contacted are in Appendix A.

Internal Controls

We evaluated the effectiveness of internal controls in the financial reporting systems for central design activities intended to disclose the extent of cost overruns incurred on reimbursable orders. We concluded that controls in the Navy's financial accounting systems adequately disclosed the extent of cost overruns incurred by the design activities and no material internal control weaknesses were found. Because of the specialized nature of this audit, we did not evaluate the central design activities' overall implementation of the DoD Internal Management Control Program. However, appropriate management action taken against repeated violators of the prohibition on incurring cost overruns on customer orders should resolve the problem.

Prior Audits

The Naval Audit Service (NAS) issued two audit reports that addressed frequent customer order overruns by NCTC design activities. A third NAS report addressed overruns, referred to as unbillable work-in-process, incurred at 18 of the 19 Navy Industrial Fund activities reviewed.

The NAS issued Report No. S40176, "Automated Cost Accounting System for Naval Regional Data Automation Centers and Naval Data Automation Facilities," on June 29, 1987. The report disclosed that Naval Data Automation Command field activities performed work for customers without adequate funding. The NAS recommended that the Naval Data Automation Command (merged with the Naval Telecommunications Command in April 1990 to form NCTC) require field activities to renegotiate customer work requests before exceeding available funds when it becomes apparent costs will exceed the authorized limitations. The Naval Data Automation Command concurred with the recommendation and provided guidance that the Naval Regional Data Automation Centers take prompt action to avoid an overrun by using the 75-percent report produced monthly by the Authorization Accounting Activity. This report identified orders where billings to date were between 75 and 100 percent of the customer's order.

The NAS issued Report No. 036-S-92, "Followup Audit of Automated Cost Accounting System for Naval Regional Data Automation Centers and Naval Data Automation Facilities," on March 18, 1992. The report disclosed that

NCTC activities (systems design and data processing activities) continued to perform work for customers when costs exceeded available customer funding. Customer order overruns averaging about $2.2 million existed at the end of each fiscal year from FY 1984 through FY 1990. This was a repeat condition from NAS Report No. S40176, discussed above. The NAS recommended that the CNO direct the NCTC to terminate services if renegotiations with customers fail and funding runs out, as required by Comptroller of the Navy Manual, paragraph 054030.3. The CNO concurred with the recommendation and informed the NCTC of the Comptroller of the Navy regulations prohibiting the continuation of work after funding is exhausted and the requirement to stop work when funds are exhausted. At the time of our audit, this condition had not been corrected. Additional details are discussed in Part II of this report.

The NAS issued Report No. 075-S-92, "Financial Audit of the Navy Industrial Fund (17X4912) Fixed Asset Account," on June 30, 1992. The report disclosed that 18 of the 19 Navy Industrial Fund activities that were reviewed had incurred unbillable work-in-process costs of about $231 million. The report recommended that the Assistant Secretary of the Navy (Financial Management) disclose the existence and value of unbillable work-in-process and the potential for losses. The Assistant Secretary agreed and responded that a new account, Accounts Receivable - Unbilled, has been established to account for those items recognized as revenue in the proper accounting period but not billed due to insufficient funding.

Part II - Finding and Recommendation

Management of Customer Orders

Naval systems design activities continued to perform work for customers when the costs exceeded available customer funding. We attribute the condition to the Navy's lack of appropriate action to hold managers accountable for noncompliance with fiscal controls. As a result, cost overruns of $1.6 million were incurred on Joint Logistics Systems Center reimbursable orders issued to naval design activities in FY 1992. Continued work on projects beyond funding authorizations results in the delayed receipt of revenues, and could also result in losses at Navy activities for work performed that was never funded.

Background

To accomplish its mission, JLSC issues reimbursable orders, Military Interdepartmental Purchase Request, DD Form 448, to identify required tasks. Each DD Form 448 specifically states that the amount of funds cited therein may not be exceeded without prior written approval of the JLSC.

DoD and Navy guidance on the control and use of customer funds provided on reimbursable orders is contained in DoD Directive 7200.1, "Administrative Control of Appropriations," May 7, 1984, and Comptroller of the Navy Manual, volume V, "Navy and Marine Corps Industrial Funds," revised September 1988. The Comptroller of the Navy Manual, paragraph 054021.2, requires Navy activities to renegotiate customer work requests when overruns become evident before completing the work. Paragraph 054030.3 of the manual states that renegotiations should take place whenever cost performance indicates the need for adjustment to the funding ceiling, but normally before cost performance has exceeded 75 of the ceiling amount.

As described in prior audit coverage, cost overruns have been identified as a recurring problem. In response to a NAS audit report, the CNO specified, in a December 3, 1991, memorandum to all of the major Navy commands that have design and data processing activities, that:

> ... the customer overrun condition continues to be a serious problem. To correct this situation.... Naval Computer and Telecommunications Command is directing subordinate activities to effect timely renegotiation for revisions to cost reimbursable orders when cost performance indicates a need for adjustments. Renegotiations will take place before cost of performance has exceeded 75 percent of the ceiling amount of existing orders. In those instances where renegotiation fails and funding is exhausted, services will be terminated. The customer and their management command will be notified in writing of the planned work stoppage. CNO will be apprised 48 hours prior to the planned cessation of work.

Management of JLSC Orders

Although the issue of customer overruns had been reported twice and the prohibition on customer order overruns had been reiterated a number of times, the naval design activities continued the practice of performing work for customers when costs exceeded available customer funding. We attribute the primary cause for the continued noncompliance with Navy guidance to the lack of action by Navy management officials on repeated offenders of the prohibition against incurring cost overruns.

We identified cost overruns of $1.6 million on JLSC reimbursable orders at design activities of the NCTC and two other Navy major commands. The extent of the overruns is shown in the following table.

Extent of Overruns
(Million)

Activity*	Order No.	Amount Funded	Amount Expended	Percent Over
JAX NCTS	RM-92-064	$1.290	$1.603	24
NAVSEASYSCOM	RM-92-013	0.451	0.501	11
NAVSUPSYSCOM	RM-92-008	3.100	3.184	2
NAVSUPSYSCOM	RM-92-021	5.900	7.037	19
Total		$10.741	$12.325	

*JAX NCTS = Jacksonville NCTS
NAVSEASYSCOM = Naval Sea Systems Command
NAVSUPSYSCOM = Naval Supply Systems Command

The activities were not in compliance with Comptroller of the Navy Manual and CNO guidance because work was not discontinued when it was identified that additional funds would be required and renegotiations with customers had not provided additional funds in a timely manner. For example, the Jacksonville NCTS had been renegotiating the extent of funds to be provided by JLSC for 6 months (that is from March through September 1993). In the meantime, the Jacksonville NCTS continued to incur expenses on the project. In a September 25, 1993, letter JLSC advised the Jacksonville NCTS that it would cover all of the overruns. The JLSC letter also reiterated that "absolute adherence to JLSC MIPR [Military Interdepartmental Purchase Request] authority is crucial to system integrity and fiscal responsibility. In no instance will you [that is, Jacksonville NCTS] ever exceed the amount on JLSC MIPRs."

When we questioned management personnel (commanders, project managers, and accounting personnel) at the design centers, including Jacksonville NCTS, they were not overly concerned about the cost overruns, because they believed that JLSC would, as in the case above, eventually provide them with additional funds to cover the overruns and that as long as they did not bill JLSC for the unfunded expenses, no repercussions would occur.

Controls in the Navy's financial accounting systems were adequate to identify the extent of overruns incurred. The financial system provides a number of reports, such as the percentage of costs incurred report, that show costs versus the amount authorized or funded for expenditure. However, use of those reports has not prevented the occurrence of overruns.

Summary

Continued performance of work that exceeds available customer funding appears to be a normal mode of operation at naval design activities, in noncompliance with Navy guidance, and could result in losses for the design activities. Previous audit reports have shown that this practice has been ongoing since at least FY 1984. Although Navy regulations clearly prohibit the practice of incurring costs that exceed authorized funding, the condition continues to occur. Controls in the Navy's financial accounting systems readily identify the extent of overruns incurred and as reported by the NAS in June 30, 1992 (see prior audits), it could be substantial. We believe that upper management levels should review financial reports and take action to ensure that cost overruns are prevented.

Recommendation, Management Comments, and Audit Response

We recommend that the Chief of Naval Operations task the Commanders of the Naval Computer and Telecommunications Command, the Naval Sea Systems Command, and the Naval Supply Systems Command to review the Joint Logistics Systems Center and other DoD customer orders to determine the full extent of customer overruns at all of its naval design activities and take appropriate action against naval design activity personnel who continue to be responsible for noncompliance with the Navy direction on customer order cost overruns.

Management Comments. The Chief of Naval Operations did not provide comments to the draft report. The Commander, Naval Computer and Telecommunications Command, concurred with the finding and recommendation, stating that every effort will be made to strictly adhere to the Navy's customer overrun policy.

Audit Response. We request that the Chief of Naval Operations provide comments to the finding and recommendation in response to the final report.

Part III - Additional Information

Appendix A. Organizations Visited or Contacted

Department of the Navy

Office of the Comptroller, Department of the Navy, Washington, DC
Headquarters, Naval Computer and Telecommunications Command, Washington, DC
  Naval Computer and Telecommunications Station, Jacksonville, FL
  Naval Computer and Telecommunications Station, New Orleans, LA
Headquarters, Naval Sea Systems Command, Washington, DC
Headquarters, Naval Supply Systems Command, Washington, DC
  Fleet Material Support Office, Mechanicsburg, PA
Naval Audit Service, Washington, DC

Defense Organizations

Defense Accounting Office, Cleveland Center, Pensacola, FL
Defense Accounting Office, Denver Center, Dayton, OH
Joint Logistics Systems Center, Dayton, OH

Appendix B. Report Distribution

Office of the Secretary of Defense

Comptroller of the Department of Defense
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Comptroller of the Navy
Commander, Naval Computer and Telecommunications Command
Commander, Naval Sea Systems Command
Commander, Naval Supply Systems Command
Commander, Fleet Material Support Office
Auditor General, Naval Audit Service

Department of the Air Force

Auditor General, Air Force Audit Agency

Defense Organizations

Headquarters, Defense Finance and Accounting Service
  Defense Accounting Office, Cleveland Center (Pensacola)
  Defense Accounting Office, Denver Center (Dayton)
Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange
Joint Logistics Systems Center

Non-Defense Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
National Security and International Affairs Division, Technical Information Center
National Security and International Affairs Division, Defense and National Aeronautics and Space Administration Management Issues
National Security and International Affairs Division, Military Operations and Capabilities Issues

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Naval Computer and Telecommunications Command Comments

DEPARTMENT OF THE NAVY
COMMANDER
NAVAL COMPUTER AND TELECOMMUNICATIONS COMMAND
4401 MASSACHUSETTS AVENUE NW
WASHINGTON DC 20394-5460

In reply refer to:

7300
Ser N71-187/
12 MAY 1994

From: Commander, Naval Computer and Telecommunications Command
To: Department of Defense Inspector General

Subj: REPORT ON NAVAL DESIGN ACTIVITIES' COST OVERRUNS ON JOINT LOGISTICS SYSTEMS CENTER'S (JLSC) ORDERS (PROJECT NO. 2LD-2021.01)

Ref: (a) Audit Report to Assistant Secretary of the Navy (Financial Management) on Naval Design Activities' Cost Overruns on JLSC orders

1. Reference (a) identified a finding of Naval Design Activities performing work for customers that exceeded available customer funding. To correct this problem, DOD(IG) recommended that Navy management officials review cost overrun reports to determine the full extent of customer overruns at Navy Design Activities and take appropriate action against personnel responsible for continued noncompliance with Navy direction.

2. The Naval Computer and Telecommunications Station, (NAVCOMTELSTA) Jacksonville was identified as one of the Naval Design Activities that continued to perform work for JLSC when the costs exceeded the available funding.

3. NAVCOMTELCOM concurs with the audit report and as noted in the report, NAVCOMTELCOM has directed subordinate activities to adhere to the tenents of the Comptroller of the Navy Manual, paragraph 054021.2, on several occasions. NAVCOMTELCOM will continue to make every effort to strictly adhere to customer overrun policy. Questions concerning NAVCOMTELCOM's policy should be directed to Mr. Harold Randle, at commercial (202) 282-0893.

M. J. SCHILDWACHTER
By direction

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