October 28, 2005

Financial Management

Independent Examination of Valuation and Completeness of U.S. Army Corps of Engineers, Buildings and Other Structures (D-2006-009)

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Acronyms

CEFMS	Corps of Engineers Financial Management System
COEMIS	Corps of Engineers Management Information System
EC	Engineer Circular
ER	Engineer Regulation
FMR	Financial Management Regulation
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GLAC	General Ledger Accounting Code
PP&E	Property, Plant, and Equipment
MOA	Memorandum of Agreement
OIG	Office of Inspector General
REMIS	Real Estate Management Information System
USACE	U.S. Army Corps of Engineers

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October 28, 2005

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Report on Independent Examination of Valuation and Completeness of U.S. Army Corps of Engineers Buildings and Other Structures (Report No. D-2006-009)

We are providing this report for your information and use. This is the third in a series of reports related to management assertions by the U.S. Army Corps of Engineers on Civil Works buildings and other structures. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Carmelo G. Ventimiglia at (317) 510-3855 (DSN 699-3855) or Mr. George DeBlois at (317) 510-3852 (DSN 699-3852). See Appendix H for the report distribution. The audit team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

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Service

Department of Defense Office of Inspector General

Report No. D-2006-009 **October 28, 2005**
(Project No. D2004-D000FI-0037.002)

Independent Examination of Valuation and Completeness of U.S. Army Corps of Engineers Buildings and Other Structures

Executive Summary

Who Should Read This Report and Why? U.S. Army Corps of Engineers (USACE) and Department of Defense personnel responsible for the financial reporting and accountability of buildings and other structures should read this report. The report discusses the accuracy of assertions about the valuation and completeness of buildings and other structures and the related transactions reported in the USACE, Civil Works financial statements.

Background. General Property, Plant, and Equipment was the largest category of assets reported in the USACE, Civil Works financial statements for the fiscal years ending September 30, 2004 and 2003. In this category, buildings and other structures comprised $18.3 billion of the $30.9 billion reported in FY 2003 and $16.1 billion of the $28.4 billion reported in FY 2004. Buildings and other structures include all buildings, structures, and other facilities affixed to USACE land in the continental United States, Alaska, and Hawaii.

Assertions are representations by management that are embodied in the financial statements. This is the third and final in a series of reports related to management assertions by USACE on its Civil Works buildings and other structures. In the two previous reports, we determined that USACE misreported the existence of 164 of 1,211 sampled buildings and other structures, valued at $594.9 million, and the rights of an additional 208 sampled buildings and other structures, valued at $55.5 million, as of June 30, 2003. However, in those reports we did not statistically project the effect that the problems with the sample items had on the balances in the buildings and other structures accounts that USACE used to report General Property, Plant, and Equipment. This report will address the effect the misstatements had on the USACE, Civil Works Balance Sheet. We performed this examination in support of the audit of the principal USACE, Civil Works financial statements for the fiscal years ending September 30, 2004 and 2003.

Results. USACE materially misstated the value of buildings and other structures reported on its June 30, 2003, Civil Works Balance Sheet by an estimated $4.4 billion. In addition, USACE could not provide documentation to support the recorded book value of $1.8 billion in buildings and other structures. As a result, the USACE management assertion that material transactions were properly recorded in the accounting records was inaccurate. The failure to identify and correct the inaccuracies resulted in a material misstatement of the FYs 2003 and 2004 Civil Works Balance Sheets. Until USACE districts fully implement corrective actions that were initiated in July 2004, the Civil Works Balance Sheet will remain materially misstated. USACE should resolve the errors

discussed in this report and validate the implementation of the Memorandum of Agreement, including the proper recording and support for the book costs and placed-in-service dates of USACE buildings and other structures. USACE needs to develop and enforce a consistent useful life policy and publish updated guidance that provides districts with detailed procedures for addressing other problem areas. USACE also needs to determine the feasibility of a system change to better control the establishment of useful lives and changing the method used to begin depreciating buildings and other structures (finding A).

USACE failed to report 147 structures correctly, with an estimated net book cost of $3.7 million and a net book value of about $1 million, in its Civil Works Balance Sheet and notes as of June 30, 2003. During completeness testing, we identified 84 structures that were not capitalized and 43 structures that were not retired as of June 30, 2003. Additionally, districts failed to consistently capitalize structures that met the USACE capitalization threshold. As a result, the structures reported in general ledger account codes 1730 (buildings) and 1740 (other structures) were inaccurate. USACE should improve inventory management procedures and ensure that the Corps of Engineers Financial Management System accurately reflects inventory results. USACE should also develop a clear policy for capitalizing principal structures and integral components (finding B). (See the Findings section for detailed recommendations.)

Management Comments and Audit Response. The Commander of USACE concurred with the findings and recommendations and stated that an updated Information Paper No. 10, "Buildings and Other Structures," was issued to districts to implement corrective actions for buildings and other structures identified in this and previous reports. He developed new regional assessment teams to validate such items as placed-in-service dates, recorded book costs, and compliance with new useful life policies. The Commander stated that Engineer Regulation 37-1-30 and Engineer Circular 405-1-2 are being revised to include all guidance related to real property assets. He also stated that USACE would assess the economic and financial impacts of making system changes to the Corps of Engineers Financial Management System and use the results to determine the feasibility of making the system changes. Further, the Commander stated that a waiver from DoD policy will be requested from the Under Secretary of Defense (Comptroller) for USACE-unique assets. (See the Findings section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.)

Management Actions. During the course of this independent examination, USACE began to take corrective actions to resolve problems we identified. In July 2004, USACE provided its districts with Information Paper No. 10 that addressed the corrective actions needed to resolve issues identified during our independent examination. We reviewed the status of corrective actions as of the end of FYs 2003 and 2004 and as of December 31, 2004. Although limited corrective actions had been completed by the end of FY 2004, USACE districts made a more concerted effort to resolve identified errors beginning in the first quarter of FY 2005. In May 2005, USACE sponsored a workshop in which representatives from each district were placed on regional teams and empowered to help correct deficiencies within the districts. (See the Findings section of the report for a complete discussion of the management actions.)

Table of Contents

Background

The U.S. Army Corps of Engineers (USACE) reports General Property, Plant, and Equipment (PP&E) as an asset line item on its Civil Works Balance Sheet. The net book value represents the difference between the historical acquisition (book) cost and the associated accumulated depreciation of the assets. For FY 2003, the net book value of general PP&E was $30.9 billion. Buildings and other structures[1] comprised $18.3 billion of the total general PP&E. For FY 2004, the net book value of general PP&E was $28.4 billion. Buildings and other structures comprised $16.1 billion of the total general PP&E. As of September 30, 2003, USACE had about 40,000 structures located at about 1,273 field sites in the continental United States, Alaska, and Hawaii.

Financial Statement Assertions. Generally accepted accounting principles (GAAP) describe assertions as representations by management that are embodied in financial statement components. The assertions can be either explicit or implicit and can be classified according to the following broad categories: existence or occurrence (existence), rights and obligations (rights), valuation or allocation (valuation), presentation and disclosure, and completeness. Assertions about valuation address whether asset, liability, equity, revenue, and expense components have been included in the financial statements at appropriate amounts. Assertions about completeness address whether all transactions and accounts that should be presented in the financial statements are included.

FY 2003. USACE management is responsible for the fair presentation of their Civil Works financial statements and the Required Supplementary Stewardship Information. They are also responsible for establishing and maintaining a system of internal control. The USACE "Management Representation Letter for the FY 2003, Civil Works, Financial Statements," December 3, 2003, asserted that:

- representations were presented fairly in accordance with GAAP;
- material transactions were properly recorded in the accounting records underlying the financial statements or disclosed in the notes to the financial statements;
- all Civil Works buildings and other structures capitalized under $25,000 (excluding revolving fund structures and Power Marketing Agency assets) were expensed in FY 2003 and removed from the Corps of Engineers Financial Management System (CEFMS);
- long-lived assets (structures) and certain identifiable intangibles were reviewed and a determination was made that if events or changes in circumstances caused impairments, the reported amounts of assets would be accounted for, appropriately recorded, and adjusted; and
- provisions were made to reduce excess or obsolete inventories to their estimated net realizable value.

[1] In this report, the term "structures" includes buildings and other structures unless otherwise specified.

The letter also stated that in FY 2003 a material weakness existed in controls over additions and deletions to structures and those corrective actions were ongoing.

FY 2004. In "Management Assurance Concerning U.S. Army Corps of Engineers, Civil Works, FY 2004 Financial Statements Taken as a Whole," November 8, 2004, USACE asserted that the FY 2004, USACE, Civil Works financial statements may not be fairly presented in conformity with Federal accounting standards. The major deficiency was the inability to provide sufficient documentation to support the historical cost of many of the older assets. The DoD Office of Inspector General (OIG) and USACE agreed to alternate methods of documentation in a Memorandum of Agreement (MOA), "Support for Recorded Book Cost of General Property, Plant, and Equipment Assets, U.S. Army Corps of Engineers, Civil Works," on June 9, 2004.

Previous Reports. DoD IG Report No. D-2005-035, "Existence of U.S. Army Corps of Engineers Buildings and Other Structures," February 15, 2005, reported that USACE had misreported the existence of 164 of the 1,211 sampled structures, with a net book value of $594.9 million, as of June 30, 2003. DoD IG Report No. D-2005-046, "Independent Examination of the Rights to U.S. Army Corps of Engineers Buildings and Other Structures," March 25, 2005, determined that USACE misreported the rights to an additional 208 sampled structures, with a net book value of $55.5 million, as of June 30, 2003. We determined that the entire book value of 365 of the 372 sampled structures was fully misstated and should be removed from CEFMS. This report will summarize those misstatements and address the results of testing on the remaining 846 structures for the accuracy of USACE valuation assertion. This report will also address the results of testing the CEFMS structures database for completeness.

Objective

The objective of this attestation engagement was to verify accuracy in the buildings and other structures portion of the general PP&E line item and related note disclosure to the FY 2003 Balance Sheet. We expanded the engagement to determine whether the problems that we identified with the sampled structures were corrected as of September 30 and December 31, 2004. We performed the procedures in accordance with generally accepted government accounting standards, incorporating attestation engagement standards. See Appendix A for a discussion of the scope and methodology, Appendix B for prior coverage related to the objective, and Appendix C for a glossary of terms used throughout the report.

A. Valuation of USACE Buildings and Other Structures

USACE materially misstated the book value of structures reported on its June 30, 2003, Civil Works Balance Sheet by $4.4 billion. In addition, USACE could not provide documentation to support the recorded book value of $1.8 billion in structures. The misstatements occurred because USACE personnel did not:

- ensure that structures physically existed in the condition and classification recorded in the accounting records or were being used for an intended purpose,
- properly record the rights to the reported structures,
- ensure that documentation was available to properly support the placed-in-service dates and recorded historical book costs of structures, and
- properly establish recovery periods to depreciate the structures.

As a result, the USACE management assertion that material transactions were properly recorded in the accounting records was inaccurate. The failure to identify and correct the inaccuracies resulted in a material misstatement of the FYs 2003 and 2004 Civil Works Balance Sheets. Until USACE districts fully implement corrective actions that were initiated in July 2004, the Civil Works Balance Sheet will remain materially misstated.

Criteria

Statement of Federal Financial Accounting Standards. Statement of Federal Financial Accounting Standards No. 6, "Accounting for Property, Plant, and Equipment," June 1996, contains accounting standards for federally owned general PP&E. General PP&E is defined as tangible assets that:

- have an estimated useful life of two or more years,
- are not intended for sale in the ordinary course of business, and
- are intended to be used or available for use by the entity.

General PP&E should be recorded at cost, which includes all costs incurred to bring the general PP&E to a form and location suitable for its intended use. Constructed general PP&E should be recorded in a construction-in-process account until it is placed in service, at which time the balance is transferred to either the buildings account (general ledger account code [GLAC] 1730) or the other structures account (GLAC 1740).

DoD Financial Management Regulation. The DoD Financial Management Regulation (FMR), volume 4, "Accounting Policy and Procedures," chapter 6, "Property, Plant, and Equipment," August 2000, contains the DoD accounting standards for general PP&E. Depreciation expenses are to be calculated and accumulated by using the straight-line method based on the recorded cost, less salvage value, and divided equally among accounting periods during the structure's useful life. Accumulated depreciation is the amount of depreciation expense that has been added over a period of time and calculated from the placed-in-service date of the asset. DoD FMR, volume 4, assigns a useful life of 40 years for buildings and 20 years for other structures. For the purpose of calculating depreciation, structures do not have salvage value.

Memorandum of Agreement. USACE lacked documentation to support the book cost of a significant portion of its general PP&E assets. In coordination with USACE and the Government Accountability Office (GAO), we developed standards for acceptance of supporting documentation. However, the types and availability of documentation varied for structures that were placed in service before the implementation of CEFMS and those placed in service after implementation. During the audit, these standards were incorporated into an MOA between USACE and DoD OIG. See Appendix D for more details concerning the MOA.

Sampling Methodology

We tested a statistical sample of 1,211 property identification codes at 43 project sites for accuracy of the USACE assertions made on the financial data. The projection of the potential misstatement in the structures portion of the general PP&E line item was based on the results of our existence, rights, and valuation testing. See Appendix E for more details concerning sampling methodology.

On previously performed testing[2] of the sampled structures for the existence and rights assertions, we determined that the entire book value of 365 sampled structures, valued at $631.5 million, was fully misstated and should be removed from CEFMS. Therefore, we did not perform additional valuation testing on those structures.

To test the valuation assertion for the remaining 846 structures, we conducted tests to determine whether structures were:

- supported by documentation that verified the book costs and placed-in-service dates,
- recorded at the correct book costs,
- placed in service on the correct dates,

[2] DoD IG Report No. D-2005-046, "Independent Examination of the Rights to U.S. Army Corps of Engineers Buildings and Other Structures," March 25, 2005, and DoD IG Report No. D-2005-035, "Independent Examination of the Existence of U.S. Army Corps of Engineers Buildings and Other Structures," February 15, 2005.

- assigned the correct useful lives, and
- recorded at the correct book values as of June 30, 2003.

Supportability of CEFMS Book Cost and Book Value

Of the 846 sampled structures, 112 did not have the documentation required by the MOA to support all or part of their book costs and book values. Table 1 shows the level of documented support for the 846 sampled structures and their associated book costs and book values.

Table 1. Support for Book Costs

Level of Support	Number of Sample Items	Book Cost (in millions)	Book Value (in millions)
Fully supported	734	$3,528.0	$2,579.0
Fully unsupported	55	66.6	59.9
Partially unsupported	57	753.3	689.0

We are 95 percent confident that, when we projected the unsupported amounts over the entire population, USACE did not have documentation to support between $721 million and $2.9 billion of the reported book value of structures as of June 30, 2003. Appendix E provides details of the sample projections.

Fully Unsupported Book Costs. USACE personnel could not provide documentation to support the recorded book costs of 55 sampled structures. At 4 project sites, we identified 33 structures that were not properly supported by a conversion spreadsheet. Pittsburg District personnel could not provide us with the conversion spreadsheet for Youghiogheny Lake, Pennsylvania, where 12 of the 33 sampled structures were located. Also, the conversion spreadsheets at Cooper Dam and Ray Roberts Lake, Texas, and Richard B. Russell Dam, South Carolina, had significant flaws that needed to be corrected before we could consider the conversion spreadsheets as adequate support for 21 sampled structures. See Appendix F for more details concerning the Corps of Engineers Management Information System (COEMIS) to CEFMS conversion process.

At 12 project sites, we identified 22 structures that did not have sufficient found-on-works appraisals or third party documentation to support the recorded book costs in CEFMS. For example, USACE personnel were not able to provide documentation to support the book cost of a hazardous waste building placed in service on May 12, 2000, in Walla Walla, Washington. We considered the book cost of each of the 55 sampled structures to be unsupported and excluded them from further valuation testing.

Partially Supported Book Cost. USACE personnel could not provide documentation to support portions of the recorded book cost for an additional 57 sampled structures. Of the sampled structures, 44 were placed in service before CEFMS implementation, but the amounts recorded in CEFMS did not match the reconciled conversion spreadsheets and USACE personnel did not provide additional support to explain the difference. The remaining 13 sampled

structures were placed in service after conversion but lacked the required third party documentation to support a portion of the recorded book cost. The following are some examples of partially supported book cost.

- A cutoff wall dam at Beaver Lake in Rogers, Arkansas, had a CEFMS book cost of $26,521,654.36, but the conversion spreadsheet used as support assigned a book cost of $26,399,342. The district was unable to provide any supporting documentation for the $122,312.36 difference in book cost.

- Recreational campsites at Canyon Lake Park, Texas, were placed in service on July 27, 1999, after CEFMS implementation. We obtained third party documentation that supported a book cost of $359,433.67. However, the book cost recorded in CEFMS was $437,130.84. The $77,697.17 difference was unsupported.

Therefore, we did not include these unsupported costs in any projection of the known misstatement of the buildings and other structures accounts.

Conclusion. USACE did not have documentation to support a significant portion of the reported book value of structures reported on the FY 2003 and 2004 Civil Works Balance Sheets. The MOA provides guidance as to what documentation should be available to support the book cost of each structure in CEFMS. USACE headquarters personnel must validate that each district complied with the MOA requirements. Districts must determine whether the book cost of each structure in CEFMS is properly supported and, as necessary, correct conversion spreadsheets and obtain additional documentation. Conversion spreadsheets with significant flaws must be reconstructed to provide adequate support for structures placed in service before conversion to CEFMS. Any remaining unsupported book costs should be removed from CEFMS. Furthermore, supporting documentation must be maintained in a readily available location for the required retention time. The lack of supporting documentation made it impossible to determine whether the reported book costs represented only those costs required to bring the structures to a form and location suitable for their intended use, or whether the costs included should have been expensed or capitalized elsewhere.

Book Value Projections

Overall, we are 95 percent confident that USACE misstated the book value of the structures portion of its general PP&E line item by between $3.3 billion and $5.5 billion as of June 30, 2003. Appendix E provides details of the sample projections. This overstatement exceeded the test materiality of $378.6 million. The projection was based on the existence, rights, and valuation testing we performed on the 1,211 sampled structures. The remainder of this report uses the sample data to quantify test results. Table 2 shows the known misstated amounts of book cost and book value of the sampled structures by the assertion tested.

Table 2. Sample Misstatements as of June 30, 2003			
Assertion Tested	Number of Errors	Book Cost (in millions)	Book Value (in millions)
Existence	163*	$ 887	$595
Rights	208	74	55
Valuation	779	84	338
Total	**1,150****	**$1,045**	**$988**

* Six structures partially failed existence testing. We subjected the existing portions of the six structures to rights and valuation testing.
** Six structures failed more than one assertion.

We provided detailed audit results to the 18 district commanders responsible for the 43 sites we visited. Appendix G identifies the date of each memorandum and provides an example of the memorandum we sent to each district commander.

Existence Testing

DoD IG Report No. D-2005-035 identified that 164 of the sampled structures[3] failed existence testing. As a result, about $595 million in book value reported on the balance sheet for these sampled structures was considered misstated. We determined that USACE personnel did not follow established procedures to determine whether:

- a tangible structure existed in a condition consistent with the supporting documentation,
- property identification codes were properly classified,
- impairments to structures were identified and retirement transactions were recorded in CEFMS in the period that the impairment occurred, and
- structures that no longer provided an operational service to USACE were retired from CEFMS.

In DoD IG Report No. D-2005-035, we reported that physical inventories conducted by district personnel were not effective and did not result in proper reconciliations.

[3] Subsequent to issuing DoD IG Report No. D-2005-035, Portland District provided additional documentation supporting the existence of one structure. Therefore, we included it in the valuation testing.

Rights Testing

DoD IG Report No. D-2005-046 identified that 208 sampled structures failed rights testing. As a result, the $55.5 million in book value reported on the balance sheet for the 208 sampled structures was considered misreported. USACE had not developed policies and procedures to require district personnel to:

- identify whether structures being leased to other entities should have been classified as capital leases,
- retire structures from CEFMS upon transfer to other Government entities, and
- retire structures from CEFMS upon transfer to local governments and private entities.

USACE had 208 structures that qualified as capital leases or were transferred to other entities and should have been removed from the buildings and other structures accounts.

Valuation Testing

Valuation testing conducted on the remaining 791 sampled structures[4] identified 779 structures that failed one or more of the valuation tests. We tested the 791 structures to determine whether their book costs, placed-in-service dates, and useful lives were correctly established. For the sampled structures that had accurate book costs, placed-in-service dates, and useful lives, we determined whether depreciation was calculated correctly. Valuation test failures resulted in a $338 million misstatement in book value as of June 30, 2003. Table 3 shows the number of errors for each type of valuation test.

Table 3. Valuation Test Failures

Reason for Failure	Number of Errors*
Book cost misstatements	61
Placed-in-service dates	147
Useful lives	584
Depreciation calculation	141

* 633 structures failed 1 valuation test and 146 structures failed 2 or more valuation tests.

Book Cost Misstatements. USACE did not properly record the book cost of 61 sampled structures, causing the net book cost to be overstated by $83.9 million. District personnel did not always verify that only costs incurred to bring the structure to a form and location suitable for its intended purpose were

[4] We did not conduct valuation testing on the 365 structures that failed existence and rights testing. We also excluded 55 structures from valuation testing because their full book costs were fully unsupported.

capitalized. District personnel did not accurately determine whether specific costs should have been capitalized or expensed. As a result, costs such as maintenance and repair were erroneously capitalized. Furthermore, the costs of improvements that extended the useful life or improved the efficiency of structures were not capitalized in accordance with the DoD FMR. The following are examples of structures with misstated book costs.

- The book cost of the lock at Robert C. Byrd Lock and Dam, West Virginia, included $4 million in bank stabilization costs. The bank stabilization costs were actually stone and fabric for maintenance and repair of the riverbank that should have been expensed.

- The costs to replace the roof of the powerhouse at Harry S. Truman Lake, Missouri, were erroneously capitalized. According to the power plant manager, the roof was replaced because it was leaking. In accordance with the DoD FMR, the $630,598.22 spent to repair the roof should have been expensed.

- Additional costs to improve the existing lock structures at Melvin Price Lock and Dam, Illinois, were capitalized as separate structures instead of being capitalized as betterments to the lock structures. Consequently, USACE did not determine whether the betterment improved or extended the useful life of the lock and should have been capitalized and depreciated, or whether these costs should have been expensed.

USACE resource management personnel should review the book costs for the structures and ensure that only those costs needed to bring the structures to a condition and location suitable for their intended use are capitalized. If costs are for maintenance and repair, or do not improve or extend the useful life of a structure, the costs should be expensed.

Placed-in-Service Dates. District personnel did not follow USACE procedures when entering the placed-in-service dates for structures in CEFMS. At 26 of the 43 field sites, 147 sampled structures had incorrect placed-in-service dates. The placed-in-service date in CEFMS should be the date the structure is ready and available for use and is essential in computing depreciation. Resource management personnel failed to verify the completion dates reported on the conversion spreadsheets and Engineer Form 3013, "Work Item Completion Report," when entering the dates in CEFMS. Because USACE used the month available for service method to compute depreciation, the placed-in-service date entered in CEFMS must be within the same depreciation month as the structure's date of completion. Otherwise, the structure would begin depreciating in the wrong month. District personnel did not establish the correct placed-in-service dates in CEFMS for the 147 sampled structures. Consequently, the accumulated depreciation on each of the 147 sampled structures was incorrect. This error resulted in the overstatement or understatement of the book value of the sampled structures.

Structures on Conversion Spreadsheets. The conversion spreadsheets did not always list a placed-in-service date for every structure. In addition,

information on the conversion spreadsheet was sometimes incorrect or not used when entering the placed-in-service dates in CEFMS. The following are examples of errors on the conversion spreadsheets.

- Three structures at Robert C. Byrd Lock and Dam, West Virginia, were assigned placed-in-service dates of December 1, 1987, on the conversion spreadsheet. However, project site personnel indicated that the three structures were part of the original project construction completed in 1937. Therefore, the structures had not been depreciated for about 50 years.

- At Arcadia Lake, Oklahoma, district personnel used January 1 of the year of acquisition as the placed-in-service date for all structures converted from COEMIS to CEFMS. However, January 1 was often not the actual date listed on the conversion spreadsheets. As a result, the placed-in-service dates for 15 sampled structures should have been 1 to 3 months later than the dates in CEFMS.

The MOA required that the placed-in-service date certified on the conversion spreadsheet be used to support the date in CEFMS. USACE must ensure that the placed-in-service dates in CEFMS are correct.

Post-Conversion Structures. Structures placed in service after the implementation of CEFMS had placed-in-service dates that were not consistent with the dates of completion reported on Engineer Form 3013. This form was used as the control document for identifying the date the structure was physically completed and available for use. However, district personnel used other dates, such as the dates that the person entered information about the structure into CEFMS, as the placed-in-service dates. In addition, district resource management personnel were not ensuring that the date of completion shown on Engineer Form 3013 reflected the actual date of completion shown on the supporting documentation. The following are examples of post-conversion errors.

- A structure at Oahe Dam located near Pierre, South Dakota, had a placed-in-service date in CEFMS of September 28, 2000, but the Engineer Form 3013 listed a date of completion of July 25, 2000.

- A structure at Bo Woods recreation area located near Shelbyville, Illinois, had a placed-in-service date in CEFMS of November 13, 2002. However, the supporting documents showed the actual completion date was on or before July 18, 2001.

Methods of Depreciation. The DoD FMR allows either the month available for service method or the midyear convention method for commencing depreciation. The month available for service method starts depreciation in the month the structure is available and ready for use. This method requires district personnel to establish a placed-in-service date within the same depreciation month as the date the structure is available for service. Otherwise, depreciation will be computed incorrectly. The midyear convention method assigns 6 months of depreciation in the first and last fiscal year of a structure's useful life, regardless of the actual date the structure was placed in service, as long as the structure was placed in service in the correct fiscal year. Of the 147 sampled structures with placed-in-service date errors, 28 would have had depreciation

recorded correctly if USACE had used the midyear convention method. USACE should consider the use of the midyear convention method of depreciation.

Conclusion. USACE must ensure that the correct placed-in-service date is entered in CEFMS. If USACE continues to use its current depreciation method, USACE must ensure that the appropriate personnel understand the importance of using the date of completion on the conversion spreadsheet or Engineer Form 3013 as the placed-in-service date. For newer structures, the resource management personnel need to validate that the date of completion is supported by third party documents. Because of the added significance of establishing accurate placed-in-service dates when using the month available for service method of computing depreciation, USACE should assess whether conversion to the midyear convention method is desirable.

Useful Lives. The USACE useful life policy for depreciating structures within CEFMS conflicted with established DoD policy and was implemented inconsistently. USACE established a useful life table that set useful lives for structures that were generally longer than those specified in the DoD FMR. In addition, USACE had not requested or received a waiver from the Office of the Under Secretary of Defense (Comptroller) for establishing different useful lives for USACE-unique assets. We identified 584 sampled structures located at 39 of the 43 field sites that had incorrect useful lives.

Common Structures. District personnel did not assign correct useful lives to 505 sampled structures that are common structures identified in the DoD FMR. In accordance with the DoD FMR, buildings and other structures should have been assigned useful lives of 40 years and 20 years, respectively. The assignment of incorrect useful lives affected the monthly depreciation rate and contributed to the book value misstatement, as demonstrated by the following examples.

- District personnel assigned a useful life of 100 years to a comfort station at J. Percy Priest Dam, Tennessee. Because the comfort station was classified as a building, the DoD FMR requires a useful life of 40 years.

- District personnel assigned a useful life of 100 years to a parking area at Bonneville Dam, Oregon. Because the parking area was classified as an "other structure," the DoD FMR requires a useful life of 20 years.

- A sewage system at Lake Shelbyville, Illinois, had a useful life of 50 years. Because the structure was classified as a utility, the DoD FMR requires a useful life of 20 years.

USACE-Unique Structures. USACE has structures, such as dams, locks, floodgates, and power plants, that are unique to the organization and its DoD mission. Engineer Regulation (ER) 37-2-10, chapter 31, Appendix A, "Accounting Treatment for Multiple-Purpose Project," April 1994, provides maximum useful life periods for these structures. For USACE-unique structures, USACE should have obtained a waiver from the Office of the Under Secretary of Defense (Comptroller) for exclusion from following the DoD FMR useful life tables. Despite the lack of a waiver, we determined whether USACE used the

useful lives in ER 37-2-10 for USACE-unique structures. District personnel did not assign the correct useful lives to 79 USACE-unique structures. For example, a dam at Yatesville Lake, Kentucky, and a spillway at Gilham Lake, Arkansas, were both assigned a useful life of 50 years in CEFMS, even though ER 37-2-10 assigns a useful life of 100 years for both structures. District personnel could not justify assigning shorter useful lives.

Consistent Implementation of Useful Life Policies. USACE districts did not consistently follow the useful life policies in ER 37-2-10 and the DoD FMR. Structures with similar characteristics were being depreciated over different useful lives. Each district had the ability to establish useful lives contrary to policy without justification, as demonstrated by the following examples.

- Dams in the Tulsa and St. Louis Districts were capitalized at 100 years in accordance with ER 37-2-10. Similar dams in the Fort Worth and Huntington Districts were capitalized over useful lives of 40 to 50 years. However, the districts could not provide us with documentation to support designating useful lives that were shorter than specified in ER 37-2-10.

- Parking lots at the Huntington District were capitalized at 20 years in accordance with the DoD FMR. However, similar parking lots at the Vicksburg and Little Rock Districts were capitalized at 50 and 100 years, respectively.

Because CEFMS did not automatically populate the useful life field based on the type of structure, district personnel could easily deviate from policy. Further, USACE management did not monitor the establishment of useful lives to ensure consistent application. To ensure more uniformity, USACE should develop a system change within CEFMS that would tie approved useful life tables to the property category codes assigned to different types of structures.

Conclusion. USACE should develop and publish a useful life policy that complies with DoD policy and establish useful lives for USACE-unique structures. To ensure the application of consistent useful lives, USACE should determine the feasibility of developing a system change in CEFMS that would control the establishment of useful lives based on the approved useful life tables. The system could allow deviations that are justified and supported.

Depreciation Calculation. Depreciation was not calculated correctly for 141 sampled structures that otherwise had accurate book costs, placed-in-service dates, and useful lives. As a result, the book values of the structures were misstated by $29.6 million. Some of these misstatements were caused when the depreciation by feature code in COEMIS was allocated to individual structures in CEFMS as part of the conversion process. The methodology used by USACE did not accurately spread the depreciation to each of the structures associated with the feature code. As a result, when we calculated straight-line depreciation and compared results with the accumulated depreciation amounts recorded in CEFMS, we identified differences. Some of these differences were also identified in the districts' depreciation variance reports. The variance reports identified anomalies in the depreciation account by comparing amounts recorded in CEFMS with the straight-line computation of depreciation. If used, variance reports serve

as a control to ensure that the correct amount of accumulated depreciation is recorded in CEFMS. However, district personnel did not properly calculate straight-line depreciation once an addition or betterment was made to a structure. USACE needs to periodically review and reconcile the districts' depreciation variance reports and develop a report that could be used to validate the accumulated depreciation recorded in CEFMS for structures with additions and betterments.

USACE Corrective Actions

Although USACE has begun to resolve the problems we identified, work remains to fully correct the issues. USACE published Engineer Circular (EC) 405-1-2, "Real Estate - Project Inventory Management, Accountability and Documentation," March 1, 2004, to create consistency with the accountability and valuation of structures. EC 405-1-2 was open for comment within USACE for about one year. Subsequently, the circular will be updated and reissued as chapter 16 of ER 405-1-12, "Real Estate Handbook," November 20, 1985. In July 2004, USACE provided its districts with Information Paper No. 10, "Buildings and Other Structures," which addressed the corrective actions needed to resolve many of the issues identified in this report. USACE personnel also began to draft new useful life policy for inclusion in ER 37-1-30, "Financial Administration Accounting and Reporting," September 30, 2002.

We reviewed the status of corrective actions as of the end of FYs 2003 and 2004, and as of the end of first quarter of FY 2005. Limited corrective actions were completed as of September 30, 2004. USACE districts made a more concerted effort in FY 2005 to resolve errors. Table 4 shows the progress in correcting the errors in the sampled structures.

Table 4. Remaining Sample Errors

Date of Data Reviewed	Existence Errors	Rights Errors	Book Cost Errors	Placed-in-Service Date Errors	Useful Life Errors
June 30, 2003	163	208	61	147	584
September 30, 2003	161	197	61	125	581
September 30, 2004	86	175	45	122	505
December 31, 2004	53	120	37	113	210

In May 2005, USACE sponsored a workshop in which representatives from each district were invited to attend. The districts were broken down into regional teams and empowered to help correct deficiencies within the districts. During the workshop, we briefed the regional teams on the potential audit findings and how

to overcome those deficiencies. The workshop also provided USACE with an opportunity to gain consistency in accounting procedures related to real property.

Summary

USACE assertions as to the existence of and its rights to Civil Works structures were inaccurate. These errors, along with problems recording accurate book costs, establishing correct placed-in-service dates and useful lives, and accounting for accumulated depreciation, caused the book value of structures to be materially misstated on the USACE, Civil Works Balance Sheet as of June 30, 2003. Cumulatively, the problems caused the net book value of buildings and other structures to be overstated by between $3.3 billion and $5.5 billion. (See Appendix E for sampling projections.) This misstatement exceeds the materiality threshold generally established for financial statement audits. Additional uncertainty exists as to the accuracy of the book value of structures because USACE did not have documentation to support between $0.7 billion and $2.9 billion of the reported book value of structures as of June 30, 2003. Although USACE has begun to resolve the problems identified in this and two other reports in this series of audits, further action is required. USACE must validate the implementation of the requirements in the MOA and Information Paper No. 10, update USACE guidance, provide training to district personnel, and ensure consistent implementation of the new policies and procedures throughout USACE to prevent a reoccurrence of the problems that caused the misstatements.

Recommendations and Management Comments

A. We recommend that the Chief of Engineers, U.S. Army Corps of Engineers:

A.1. Validate the implementation of the requirements contained in the Memorandum of Agreement, dated June 9, 2004, at each district. At a minimum, ensure that district offices:

a. Reconstruct the conversion spreadsheets for Cooper Dam and Ray Roberts Lake, Richard B. Russell Dam, Youghiogheny Lake and for any untested project sites that do not have conversion spreadsheets that comply with the requirements in the Memorandum of Agreement.

b. Obtain additional supporting documentation for any structures initially recorded in the Corps of Engineers Financial Management System without a fully supported book cost. Expense the unsupported differences.

c. Maintain documentation in a readily available location for the required retention period.

Management Comments. The Commander of USACE concurred and stated that the updated Information Paper No. 10 addresses the requirements of the MOA for acceptable supporting documentation and retention policies. He also stated that

newly established regional teams will review the reconstruction of the conversion spreadsheets and validate corrective actions taken by USACE districts by October 31, 2005.

A.2. Direct a review of all book costs for buildings and other structures to ensure that only those costs needed to bring the assets to a condition and location suitable for its intended use are capitalized. Expense any maintenance and repair costs or costs that did not improve or extend the useful life of the building or other structure.

Management Comments. The Commander of USACE concurred and stated that each district will review all structures to ensure that the appropriate costs are capitalized. Regional teams will validate that the reviews are completed by October 31, 2005.

A.3. Direct district resource management offices to verify that the placed-in-service dates in the Corps of Engineers Financial Management System accurately reflect the dates the structures were complete and available for use. At a minimum, these reviews should ensure that the date recorded in the Corps of Engineers Financial Management System is supported by the conversion spreadsheet or the completion date on the Engineer Form 3013.

Management Comments. The Commander of USACE concurred and stated that the updated Information Paper No. 10 provides the process that districts should utilize to verify the placed-in-service dates for all structures. He also stated that regional teams will validate districts compliance by October 31, 2005.

A.4. Perform and document a comparison of the month available for service method and the midyear convention method of commencing depreciation. Determine the feasibility of implementing the midyear convention method if determined to be more beneficial.

Management Comments. The Commander of USACE concurred and stated that USACE headquarters had completed a study of the two methods and determined that the existing method was compliant with regulations and will be maintained. He also stated that USACE will focus on complying with the month available for service method.

Audit Response. Management comments are responsive. We agree that the month available for service method is a valid depreciation method. However, USACE must ensure that the correct placed-in-service date is entered in CEFMS and ensure that districts understand the importance of using the date of completion on the conversion spreadsheet or Engineer Form 3013 as the placed-in-service date. For newer structures, the resource management personnel need to verify that the date of completion is supported by third party documents.

A.5. Develop a consistent and enforceable useful life policy for all buildings and other structures. Once developed, provide detailed training for establishing useful lives within the Corps of Engineers Financial Management System to district personnel and monitor compliance. At a minimum, the policy should:

a. Ensure that useful lives in Corps of Engineers Financial Management System are consistent for all buildings and other structures covered by the DoD Financial Management Regulation useful life tables.

b. Establish useful lives for all unique structures for which a waiver is obtained from the Under Secretary of Defense (Comptroller).

c. Ensure that useful lives are consistently implemented and that documentation exists to justify any deviations from useful life policies.

Management Comments. The Commander of USACE concurred and stated that Issue Paper No. 10 was updated to provide guidance on establishing useful lives that comply with the DoD FMR and the USACE-unique useful life table. Information Paper No. 10 also includes requirements that must be met in order to deviate from the table, as well as how to document any deviations. The Commander stated that USACE will submit a waiver to the Under Secretary of Defense (Comptroller) for its list of unique items. He also stated that CEFMS has been updated to reflect the new useful life policies. Districts will complete a 100 percent review to ensure existing assets comply with the new requirements by October 31, 2005.

A.6. Determine the feasibility of developing a system change in the Corps of Engineers Financial Management System that would automatically assign useful lives based on approved useful life tables.

Management Comments. The Commander of USACE concurred and stated that the CEFMS Development Team is evaluating the potential effect of the system change. Based on the assessment, USACE headquarters will make a decision on implementation by March 31, 2006.

A.7. Review and reconcile the depreciation variance report on a monthly basis. Develop a report to calculate depreciation variances for buildings and other structures with additions and betterments.

Management Comments. The Commander of USACE concurred and stated that a review of the calculations in the depreciation variance report determined that the depreciation variance report correctly calculates depreciation for structures with additions and betterments.

Audit Response. Management comments are responsive. USACE headquarters must ensure that districts reconcile the report on a monthly basis using the depreciation variance report.

A.8. Correct the unresolved errors identified in the memorandums we sent to district commanders that detailed the results of our work.

Management Comments. The Commander of USACE concurred and stated that each district which received a memorandum has corrected all the identified errors.

A.9. Publish updated guidance that provides districts with detailed procedures to eliminate the valuation errors identified in this report. Once published, ensure that all personnel involved with asset management are trained on the updated procedures. Specifically:

a. Update Engineer Circular 405-1-2 to provide adequate guidance to ensure the accuracy of and support for a structure's book cost, placed-in-service date, and useful life.

Management Comments. The Commander of USACE concurred and stated that Engineer Circular 405-1-2 will be updated and revised to include the guidance in Information Paper No. 10 by March 31, 2006.

b. Update Engineer Regulation 37-1-30 to provide resource management personnel guidance that formalizes the corrective actions contained in Information Paper No. 10.

Management Comments. The Commander of USACE concurred and stated that ER 37-1-30 would be updated and revised to include all the guidance in Information Paper No. 10 and other related information papers by March 31, 2006.

B. Completeness of Buildings and Other Structures Accounts

USACE failed to report 147 structures correctly, with an estimated net book cost of $3.7 million and a net book value of about $1 million, on its Civil Works Balance Sheet as of June 30, 2003. During completeness testing, we identified 84 structures that were not capitalized and 43 structures that were not retired as of June 30, 2003. Additionally, districts failed to consistently capitalize structures that met the USACE capitalization threshold and establish property identification codes. The problems occurred because USACE personnel did not follow procedures or lacked sufficient guidance to ensure that:

- physical inventories were accomplished correctly and discrepancies were adequately addressed,
- districts consistently implemented capitalization policies, and
- structures with a zero book value were assigned the proper placed-in-service dates and useful lives.

As a result, the balances reported in the buildings and other structures accounts were inaccurate and further misstated the general PP&E reported on the USACE, Civil Works Balance Sheet.

USACE Policies and Systems

Inventories. ER 405-1-12 requires that USACE real estate personnel perform real property inventories at least once every three years. The regulation also requires that inventory results be reconciled with the financial accounting system. The regulation states that real property with an inherent useful life of two or more years will be capitalized if it meets the capitalization threshold. General PP&E is recorded at cost, including all costs incurred to bring the general PP&E structure to a form and location suitable for its intended use.

EC 405-1-2 provides updated guidance for recording and inventorying real property. EC 405-1-2 requires the real property accountability officer to assign a property identification code to each item on the inventory. To facilitate physical inventories of structures, the property identification code must be shown on the structure, pictures of the structure should be taken and made available, and the inventory lists should contain brief descriptions of the structures. According to EC 405-1-2, inventory listings should include structures based on a common sense approach. For example, district personnel should include all structures that have a roof as a separate item on the inventory. Items such as camping areas, picnic areas, and other items of significant costs should be included on the inventory with a brief description. However, items such as flagpoles, signs, streetlights, and trashcans should not be listed separately. Instead, their costs should be included with the associated item on the inventory.

Real Property System. USACE uses the Real Estate Management Information System (REMIS) as its accountability system to account for and maintain its real property. It is within REMIS that the individual property identification codes are created. The property identification code information is then entered into CEFMS when the asset is ready to be placed in service.

Capitalization Threshold. USACE issued a memorandum, "Revised Policy for Financial Capitalization Threshold of Civil Works Buildings and Structures," August 12, 2003, that implemented a $25,000 capitalization threshold for all Civil Works structures other than Power Marketing Agency and revolving fund structures. Before the change, the capitalization threshold was $0 for all structures. Once the policy was issued, USACE expensed and removed from CEFMS all Civil Works structures, other than Power Marketing Agency and revolving fund structures, with a book cost of less than $25,000.

Completeness Testing

At the 43 field sites visited, USACE failed to properly record at least 147 structures with a net book cost overstatement of $3.7 million as of June 30, 2003. To determine the accuracy of the financial data recorded in CEFMS in the buildings (GLAC 1730) and other structures (GLAC 1740) accounts, we performed several completion tests. We judgmentally selected structures located at 43 field sites and determined whether USACE personnel had established a property identification code in REMIS and correctly capitalized or expensed the associated cost of each structure in CEFMS (reverse inventory). We also determined whether some judgmentally selected structures reported in CEFMS, which were not part of the statistical sample, physically existed at the field sites. Further, we determined whether structures reported at a $0 book value were accurately valued and whether USACE districts appropriately removed from CEFMS the property identification codes associated with the structures that fell below the $25,000 capitalization threshold. Table 5 shows the number and book cost misstatement of the property identification codes that failed completeness testing by type of completeness test conducted.

Table 5. Completeness Test Failures

Completeness Test	Number of Structures	Book Cost Misstatement (in millions)	Book Value Misstatement (in millions)
Reverse inventory	84	$(1.5)	$0*
Physical inventory	43	5.4	4.3
Capitalization threshold	6	(0.2)	(0.1)
Zero book value	14	0	(3.2)
Total	**147**	**$3.7**	**$1.0**

* We were unable to obtain information or documentation from USACE that would allow us to determine the book value.

Reverse Inventory

USACE did not maintain accurate inventories in REMIS at 15 of the 43 field sites visited. Our reverse inventories identified 84 structures that had not been established in REMIS. Because property identification codes were not established for the 84 structures, they were not correctly recorded in GLACs 1730 and 1740 in CEFMS as of June 30, 2003. Project managers had either failed to notify district real estate and resource management personnel of completed structures, or district personnel failed to properly conduct inventories and reconcile the results with the information in CEFMS. For example, 60 structures at Harry S. Truman Lake, Kansas, were neither recorded on the REMIS inventory list nor placed in service in CEFMS. District personnel estimated that the structures were valued at over $1.5 million. During our visit in October 2003, district real estate personnel informed us that they had established these structures in REMIS and were in the process of preparing Engineer Forms 3013 and found-on-works assessments for the structures. However, we confirmed that the structures were being used for their intended purpose prior to June 30, 2003.

Physical Inventory

Our physical inventories at 39 of the 43 field sites identified 43 property identification codes in CEFMS that did not represent structures that physically existed as of June 30, 2003. USACE personnel had not removed from CEFMS structures that no longer existed, duplicated other structures, were never constructed, or were misclassified as structures. The following are examples of physical inventory errors.

- At Canyon Lake located near Seguin, Texas, three structures had been destroyed by floodwaters in 1987 and 2002. As of March 2004, all three of the structures remained in CEFMS. District personnel had not retired the destroyed structures. As a result, the book cost of the structures was overstated by $128,312.

- Six property identification codes at Lake Shelbyville, Illinois, represented land and land improvement costs that St. Louis District personnel erroneously capitalized as structures. As a result, USACE overstated the book cost of the other structures account by $927,667.

Structures Removed Under the Capitalization Threshold

USACE personnel removed 17,760 structures with a book value of $63.3 million from CEFMS when USACE increased the capitalization threshold from $0 to $25,000. To determine whether USACE appropriately expensed the 17,760 structures, we selected and reviewed 267 property identification codes at 27 of the 43 field sites visited. USACE personnel incorrectly removed 6 of the 267 property identification codes from CEFMS because district personnel had improperly recorded components of principal structures as separate property identification codes. For example, property identification code ARLD-48849, listed in CEFMS as gate hoist machinery, was one of 32 integral structures that were capitalized separately from the main lock and dam structure at Arkansas Lock and Dam 13, Arkansas. The costs of these integral structures were erroneously removed when the capitalization threshold was increased from $0 to $25,000. The components were integral to the principal structure and should have

remained capitalized regardless of their value. As a result, the book cost of the overall lock and dam was understated by $416,929.05 and the book value was understated by $127,593.38 as of June 30, 2003.

USACE Real Estate Directive No. 13, "Reconciliation of Real Property Inventory Records with Accounting General Ledger/Cost Records," May 1994, required district personnel to assign a single property identification code to principal structures, such as dams and locks. ER 37-2-10, chapter 31, lists principal items and states that a number of components are included as integral portions to the principal structure. However, some of the districts assigned individual property identification codes to the principal structures as well as to the structures' components. USACE did not have a clear policy on how to capitalize the principal structures and integral components.

Structures With Zero Book Value

USACE district personnel had erroneously fully depreciated some structures because the structures' useful lives or placed-in-service dates were incorrectly established. To determine whether the 6,924 structures that had a zero book value as of June 30, 2003, were accurately recorded in CEFMS, we judgmentally selected 194 structures at 23 field sites for review. We determined that 14 of the 194 structures were erroneously recorded at a zero book value because their useful lives or placed-in-service dates were incorrectly established. For example, the book costs of three structures at Oahe Lake, North Dakota, were understated by $460,064.03 because two structures were assigned incorrect placed-in-service dates and the third structure was assigned an inaccurate useful life. During our review of information in CEFMS, we identified that most of the structures at three districts that we did not visit (Los Angeles, Norfolk, and New York) had been fully depreciated. We question whether all the structures that met the capitalization threshold had been recorded in CEFMS. USACE should review structures recorded with zero book value and ensure that the structures are properly valued after making any necessary adjustments in the useful lives and placed-in-service date required by new USACE guidance. USACE should give special attention to any district reporting that all its buildings and other structures are fully depreciated.

Consistency in Establishing Property Identification Codes

USACE did not enforce consistent policies among its districts on how to identify structures, when to group like structures, and how to accurately describe structures when creating property identification codes in REMIS. Without clear policy, USACE had limited assurance that districts capitalized structures consistently and CEFMS contained a complete accounting of structures. Further, USACE did not ensure that each property identification code represented a tangible asset that could be easily identified during an inventory as required by EC 405-1-2. USACE districts had inconsistent methods for grouping and identifying structures within CEFMS. In addition, during the conversion process, some districts erroneously allocated costs that could not easily be identified to property identification codes entitled "all other components" or "miscellaneous

power plant equipment." Rather than creating a separate property identification code, the costs should have been either allocated to identifiable structures or expensed.

Grouped Structures. District personnel inconsistently assigned a single property identification code to groups of structures. Because USACE personnel grouped structures together, individual structures with book costs below the capitalization threshold erroneously remained in CEFMS. USACE did not have a clear policy for capitalizing groups of structures. As a result, district personnel were inconsistent in how they capitalized structures; similar structures that were being capitalized in one district were being expensed in other districts. The following are examples of assets grouped incorrectly.

- Seventy-three gates located along the Tennessee Tombigbee River, Divide Cut, Alabama, were recorded under one property identification code with a book cost of $89,180.12. These assets were not in the same geographic location. The cumulative book costs of the 73 structures exceeded the capitalization threshold. However, the book cost of each of the individual structures was below the capitalization threshold. District personnel should have recorded these structures separately or grouped them by geographic location, such as within the same recreation area.

- Structures at Cochiti Lake, New Mexico, were listed separately on inventory records. District personnel had removed 157 campsites and picnic areas because the cost of each structure was below the capitalization threshold. At other field sites we visited, such as Harry S. Truman Lake, Missouri, similar structures, such as camp sites, were grouped together and capitalized as a single property identification code. If the structures at Cochiti Lake had been combined into one property identification code, the costs of the structures would have exceeded the capitalization threshold and been recorded in CEFMS.

USACE management needs to clarify guidance in EC 405-1-2 for capitalizing groups of structures. Similar structures should only be grouped together and considered for capitalization as a single property identification code when they are within the same geographic area. For example, costs for constructing recreational campsites within a specific area could be combined and capitalized when the total book cost exceeds the capitalization threshold. Once the policy is clarified, USACE management must ensure that it is implemented consistently by its districts.

Structure Descriptions. USACE personnel did not clearly describe some structures on the REMIS inventory list and in CEFMS. For example, USACE personnel described five property identification codes with a book cost of $12.2 million at the John Day Dam, Oregon, as "components not listed elsewhere" or as "miscellaneous accessories." However, no specific physical structure could be identified; therefore, these costs should have been either distributed to actual structures or expensed. USACE must take steps to ensure that all property identification codes reported in the buildings and other structures accounts represent an actual physical structure that can be inventoried. Otherwise, USACE district personnel should remove the property identification

codes from the REMIS inventory list. Inventory lists should also provide adequate descriptions of each individual structure to ensure accurate physical inventories and financial records. Furthermore, EC 405-1-2 requires that all structures have the property identification code affixed to the structure for identification purpose. The use of modern technology, such as Global Positioning System technology, could serve to help identify USACE structures.

Conclusion. USACE needs to improve its inventory management practices to ensure proper accountability and financial management of structures. USACE management must ensure that districts properly perform inventories at the field sites at least once every three years. CEFMS should be adjusted to reflect inventory results. District personnel must ensure that property identification codes represent tangible structures that can be easily identified during the inventory process. Use of modern technology to identify structures should be explored and implemented. USACE should develop a policy on how property identification codes are established, including when structures can be grouped, and ensure consistent implementation among districts.

Summary

The USACE buildings and other structures accounts were not complete. The 147 errors resulted in a $1.0 million net book value understatement of buildings and other structures accounts. USACE must correct the 147 completeness errors and perform a one-time, wall-to-wall inventory of structures to identify and correct similar errors and ensure that balances for buildings and other structures accounts are accurate and complete.

Recommendations and Management Comments

B. We recommend that the Chief of Engineers, U.S. Army Corps of Engineers:

B.1. Immediately resolve the 147 completeness errors identified in the district memorandums.

Management Comments. The Commander of USACE concurred and stated that the 147 completeness errors were corrected.

B.2. Direct districts to complete a one-time, wall-to-wall inventory of the structures at the project sites. Adjust the Corps of Engineers Financial Management System to reflect inventory results.

Management Comments. The Commander of USACE concurred and stated that guidance to conduct a complete inventory of all real property within USACE was in Information Paper No. 10. Regional teams will ensure compliance by October 31, 2005.

B.3. Develop a policy for the proper capitalization of principal structures and integral components. Ensure that integral components established as separate property identification codes remain capitalized as part of the principal structure.

Management Comments. The Commander of USACE concurred and stated that Information Paper No. 10 will contain guidance on the capitalization of principal structures and integral components until formal guidance can be revised. USACE districts are currently identifying principal structures and integral components and are ensuring that each is appropriately barcoded and capitalized.

B.4. Review structures recorded with zero book value and ensure that the structures are properly valued after making any necessary adjustments in the useful lives and placed-in-service date required by new U.S. Army Corps of Engineers guidance. Give special attention to any district reporting all its buildings and other structures as fully depreciated.

Management Comments. The Commander of USACE concurred and stated that a full asset review of USACE real property is underway. Regional teams will validate compliance by October 31, 2005.

B.5. Direct district personnel to review their structures in the Corps of Engineers Financial Management System and ensure that:

a. Grouped structures assigned to a single property identification code comply with Engineer Circular 405-1-2, and any exceptions are justified. Assign individual property identification codes to individual structures that have been erroneously grouped together. If the individual book cost of the formally group structures falls below the $25,000 threshold, remove the structures from the financial records.

Management Comments. The Commander of USACE concurred and stated that structure grouping procedures are being evaluated and guidance will be issued to ensure that all asset groups are valid. Structures that do not meet the capitalization threshold will be removed from CEFMS by March 31, 2006.

b. Each property identification code represents a tangible structure. For property identification codes that represent unassigned costs, allocate the costs to the proper structures or expense them.

Management Comments. The Commander of USACE concurred and stated that the full asset review of USACE real property will ensure compliance with the guidance in Information Paper No. 10. Regional teams will validate compliance by March 31, 2006.

c. Structures can be positively identified by either placing the property identification on the structure or through use of alternative methods, such as Global Positioning System technology.

Management Comments. The Commander of USACE concurred and stated that each district is identifying structures using all available means, including Global Positioning System technology. Identification of structures will be completed by October 31, 2005.

Appendix A. Scope and Methodology

USACE provided us with the universe of property identification codes (structures) contained in CEFMS that supported the amounts reported on the June 30, 2003, Civil Works Balance Sheet. We statistically selected 1,211 property identification codes for review from the universe of 32,571 structures, valued at $16.7 billion. The 1,211 sample structures were located at 43 field sites within 18 USACE districts. We performed this examination from October 2003 through May 2005 in accordance with generally accepted Government auditing standards. See Appendix E for the statistical sampling methodology.

From October 2003 through April 2004, we visited the 43 field sites. We developed procedures to test USACE management assertions about structures. To determine the accuracy of the financial data, we designed and conducted tests to verify USACE assertions related to existence, rights, and valuation of Civil Works structures. In DoD IG Report No. D-2005-035, we identified 164 sampled structures that failed existence testing. In DoD IG Report No. D-2005-046, we identified 208 sampled structures that failed rights testing. The book values of 365 of the 372 sampled structures[A-1] were fully misstated because they failed the existence or rights testing; therefore, we did not perform valuation testing on these structures. We determined the dollar value of any misstatement associated with the remaining 846 structures based on our physical observations, discussions with USACE personnel, and reviews of the available supporting documentation. We compared what was recorded in CEFMS to physical observations and available documentation to determine whether the sampled structures, as of June 30, 2003 were:

- recorded at the correct book cost,
- placed in service on the correct date,
- assigned useful lives according to DoD policy and USACE guidance, and
- recorded at the correct book value.

To test the completeness assertion, we performed several completion tests. We judgmentally selected structures located at the 43 field sites we visited and determined whether USACE personnel had established a property identification code in REMIS and correctly capitalized or expensed the associated cost of each structure in CEFMS (reverse inventory). We also determined whether some judgmentally selected structures reported in CEFMS, which were not part of the statistical sample, physically existed at the field sites. In addition, to test completeness, we judgmentally selected 194 structures at 12 of the 43 field sites that had a zero book value in CEFMS. We reviewed the documentation for each structure and determined whether the placed-in-service date and useful life were accurately recorded in CEFMS. Finally, at 27 field sites, we tested completeness by judgmentally selecting and reviewing 267 property identification codes that

[A-1] Seven assets failed existence and rights testing.

had been removed from CEFMS after USACE raised the capitalization threshold to $25,000. We determined whether the USACE decision to expense the structures was correct.

To test for presentation and disclosure, we reviewed the errors found in the sample and determined the effect on the June 30, 2003, Civil Works Balance Sheet and related note disclosures. We periodically provided our audit results to the DoD OIG audit team that was responsible for preparing DoD IG Report No. D-2005-016, "Independent Auditor's Report on the Fiscal Year 2004 U.S. Army Corps of Engineers, Civil Works, Financial Statements," November 8, 2004.

To determine progress in correcting errors that caused the buildings and other structures accounts to be misstated as of June 30, 2003, we reviewed CEFMS information for the sampled structures as of September 30, 2003; September 30, 2004; and December 31, 2004.

Use of Computer-Processed Data. Although we relied on computer-processed data from CEFMS and REMIS, we did not evaluate the adequacy of the systems' general and application controls. Previous audits have identified general and application control weaknesses and questioned the reliability of the CEFMS data. We were able to reconcile the USACE trial balances as of June 30, 2003, and September 30, 2003, for the buildings and other structures accounts within CEFMS by property identification code for the corresponding periods. We evaluated data reliability related to the sample items we reviewed by comparing information recorded in CEFMS with source documentation and physical observations at USACE district and field offices.

Use of Technical Assistance. We obtained assistance from the Operations Research Branch, Quantitative Methods Division, DoD OIG to determine a statistical sampling plan and calculate the statistical projections. See Appendix E for the statistical sampling methodology.

Government Accountability Office High-Risk Area. The GAO has identified several high-risk areas in DoD. This report provides coverage of the Defense Financial Management and Federal Real Property high-risk areas.

Appendix B. Prior Coverage

During the last 5 years, the GAO and the DoD IG have issued 12 reports discussing USACE General Property, Plant and Equipment. Unrestricted GAO reports can be accessed over the Internet at http://www.gao.gov. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports.

GAO

GAO Report No. GAO-03-42, "Financial Management: Survey of Capitalization Threshold and Other Policies for Property, Plant, and Equipment," October 15, 2002

DoD IG

DoD IG Report No. D-2005-051, "Independent Examination of the Land Assets at the U.S. Army Corps of Engineers, Civil Works," April 6, 2005

DoD IG Report No. D-2005-046, "Independent Examination of the Rights to U.S. Army Corps of Engineers Buildings and Other Structures," March 25, 2005

DoD IG Report No. D-2005-035, "Existence of U.S. Army Corps of Engineers Buildings and Other Structures," February 15, 2005

DoD IG Report No. D-2005-016, "Independent Auditor's Report on the Fiscal Year 2004 U.S. Army Corps of Engineers, Civil Works, Financial Statements," November 8, 2004

DoD IG Report No. D-2005-008, "Assessment of the U.S. Army Corps of Engineers, Civil Works, FY 2004 Beginning Financial Statement Balance of Construction-In-Progress," October 28, 2004

DoD IG Report No. D-2004-063, "Controls Over U.S. Army Corps of Engineers Buildings and Other Structures," March 26, 2004

DoD IG Report No. D-2004-059, "Assets Depreciation Reported on the U.S. Army Corps of Engineers FY 2002 Financial Statements," March 16, 2004

DoD IG (cont'd)

DoD IG Report No. D-2004-032, "Independent Auditor's Report on the U.S. Army Corps of Engineers, Civil Works, Fiscal Year 2003 Principal Financial Statements," December 3, 2003

DoD IG Report No. D-2004-017, "Reliability of Construction-in-Progress in the U.S. Army Corps of Engineers, Civil Works, Financial Statements," November 7, 2003

DoD IG Report No. D-2003-123, "Corps of Engineers Equipment Reporting on Financial Statements for FY 2002," August 20, 2003

DoD IG Report No. D-2003-043, "Independent Auditor's Report on the U.S. Army Corps of Engineers, Civil Works, Fiscal Year 2002 Principal Financial Statements," January 6, 2003

Appendix C. Glossary

Accumulated Depreciation. Accumulated depreciation is the amount of depreciation expense that has been added over a period of time and calculated from the placed-in-service date of the asset.

Acquisition (Book) Cost. Acquisition (book) cost is the original purchase, construction, or development cost, net of (less) any purchase discounts. The cost of an asset shall include all costs incurred to bring the asset to a form and location suitable for its intended use. It includes amounts paid to the prior owner or vendor, additional expenditures to place the asset in service (such as legal and recording fees, supervision and administration, engineer and design, interest during construction, labor, and transportation costs), or the fair market value of property acquired by transfer, trade-in, found on works, or donation.

Book Value. Book value is the book (acquisition) cost less accumulated depreciation charged on the asset.

Building. A building is a facility constructed on a space of land, covered by a roof, enclosed by walls, and usually with flooring.

Capitalization Threshold. The capitalization threshold is the dollar value at which costs incurred are added as capital expenditures to the placed-in-service accounts. All real property above the threshold, with an inherent useful life of 2 or more years, is capitalized.

Feature. A feature is a group of assets grouped to facilitate accounting control.

Found on Works. Found on works are assets discovered during physical inventories that have not been placed in service. A fair market value must be established for a found-on-works asset.

Improvement. An improvement is a change to an existing asset that results in an increase of efficiency, durability, or capacity of the asset or a change in the asset's useful life.

Materiality. Materiality is the magnitude of an omission or misstatement of an item in a financial report that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the inclusion or correction of the item. Planning materiality is the preliminary estimate of materiality in relation to the financial statements taken as a whole. Design materiality is the portion of planning materiality allocated to the line item and test materiality is the materiality used by the auditors in testing a specific line item. The design and test materiality were one third of the planning materiality.

Placed-in-Service Date. The placed-in-service date is the date that an asset is physically complete and available for use. Assets are recognized when the title passes to the acquiring entity or when the asset is delivered to the entity or to an agent of the entity. It defines the start of the capitalization and depreciation expense process.

Property Identification Code. A property identification code is a number that links the REMIS database with CEFMS. The property identification code is system-generated by REMIS when information about a new asset is entered and committed.

Property Phase. A property phase is a stage in an asset's life cycle. Property phases include construction in progress, placed in service, retirement, and disposal over the course of the asset's life.

Revetment. A revetment is a facing (as of stone or concrete) to sustain an embankment.

Straight-Line Depreciation Method. A straight-line depreciation method allocates the book cost of an asset equally over the course of the asset's useful life.

Structure. A structure is a real property facility that is classified as other than land, a building, or a utility system.

Useful Life. Useful life is the estimated time period for an asset to provide its intended service. The concept recognizes the deterioration of items as they age.

Utility System. A utility system is a network that provides a service or a commodity, such as water, electricity, or sewage systems, necessary to keep a facility operational.

Appendix D. Memorandum of Agreement

The MOA documented an agreement on how to support the acquisition costs and placed-in-service dates for structures. The MOA also established the retention guidelines for the documentation. The MOA divided the structures into two categories for documentation purposes: structures placed in service before and after CEFMS implementation.

Structures Placed in Service Before CEFMS Implementation. Documentation was often not available to support the acquisition costs for the individual structures accounted for in COEMIS. As a result, USACE and the DoD OIG representatives agreed that the spreadsheet used to convert USACE structures from COEMIS to CEFMS would be acceptable support for assets placed in service before CEFMS implementation. COEMIS originally tracked structure costs only by feature code. For example, feature code 01 was land, feature code 04 was dam assets, and feature code 14 was recreational structures. COEMIS could not individually account for or depreciate the individual structures. Beginning in 1994, USACE districts were directed to prepare conversion spreadsheets to allocate the COEMIS feature code costs to individual property identification codes for entry into CEFMS. Once established, the property identification codes were used to manage and depreciate structures. Each district's real estate and resource management personnel attested to the accuracy of the information on the conversion spreadsheets.

At each of the 43 sampled project sites, we verified the accuracy of the conversion spreadsheets by reconciling costs allocated from the COEMIS feature codes to the costs assigned to the individual structures originally placed in service in CEFMS. We also judgmentally selected 8 of the 43 sites to substantiate that the COEMIS amounts used for conversion were reasonably close to the amounts reported in the FY 1995 USACE Annual Reports to Congress. We used the FY 1995 USACE Annual Reports to Congress because, at that time, all USACE districts were still using COEMIS to account for structures. After the spreadsheets were validated, we accepted the placed-in-service dates and book costs reported on the spreadsheets as support for the original data entered in CEFMS. See Appendix F for a discussion of the conversion process.

Structures Placed in Service After CEFMS Implementation. For new structures and improvements to structures placed in service after a district implemented CEFMS, the MOA states that documentation substantiating the acquisition costs needed to comply with the requirements of ER 405-1-12. Otherwise, the structures had to be appraised in accordance with DoD FMR, volume 4, chapter 6. To ensure sufficient source documentation existed, district personnel were instructed to maintain a file that contains original or electronic versions of original documentation that substantiated the book cost recorded in CEFMS.

Appendix E. Sampling Methodology

Sampling Plan

Sampling Purpose. The purpose of the statistical sampling plan was to test USACE assertions about the existence or occurrence, rights and obligations, and valuation or allocation of the buildings and other structures portion of the general PP&E line on the June 30, 2003, Civil Works Balance Sheet. The sample was also used to quantify the potential misstatements of the book value of the buildings and other structures accounts.

Universe Representation. USACE provided a file that consisted of all property identification codes recorded in CEFMS and represented the cumulative dollar value of buildings and other structures recorded in the trial balance as of June 30, 2003. The total population of 57,653 property identification codes had a book cost of about $30.7 billion and a book value of about $18 billion. After August 12, 2003, when USACE increased the capitalization threshold from $0 to $25,000 (except for revolving fund and Power Management Agency assets), we excluded from the population 17,801 property identification codes with a book cost of $130.2 million that did not meet the new capitalization threshold. We also removed the following from the population:

- 6,924 property identification codes that were fully depreciated (zero book value), but had a book cost of $2.5 billion. We reviewed some of these structures as part of our completeness testing.

- 357 property identification codes that were identified as revetment assets and had a book cost of about $2.1 billion and book value of $1.3 billion. In DoD IG Report No. D-2004-017, we recommended that USACE remove identifiable revetment assets from the buildings and other structures accounts.

We provided the remaining population of 32,571 property identification codes with a book cost of $26 billion and a book value of $16.7 billion to the Quantitative Methods Division, DoD OIG.

Sampling Design. We used a probability-proportional-to-size sample in two stages. At the first stage, the Quantitative Methods Division analysts made a probability-proportional-to-size selection of 60 projects. These are technically known as primary sampling units. The probability-proportional-to-size method gives each primary sampling unit (project) initially part of the sample a chance of selection equal to its share of some common quantitative characteristic. In this instance, the common quantitative characteristic was the book value of the project. The sample was drawn with replacements, which meant not only that the project's chance of being selected related to its share of the total net book value of the buildings and other structures accounts balance, but also that the same project could be selected more than once.

At the second stage (within projects), the Quantitative Methods Division analysts determined the number of structures associated with each project. If there were 25 or fewer structures, the sample included all the structures associated with that project. If there were more than 25 structures at a project, the analysts selected the five structures with the highest book value of record and set them in one stratum (technically known as the census stratum for that project).[5] The analysts then drew a simple random sample of the remaining structures. If a project was drawn more than once, the high-value census structures remained the same, but the analysts drew another simple random sample of the remaining structures. When the same project was selected more than once, some structures were selected for more than one primary sampling unit because of the number of structures available. The sample of 60 primary sampling units involved 43 projects and 1,211 structures. When a structure was selected for more than one project sample, audit results related to that same structure were replicated across samples as necessary. This also served to slightly reduce the number of structures that needed to be audited.

Sampling Results

Table E-1 identifies the statistical estimates of known misstatement and unsupported book value as of June 30, 2003.

Table E-1. Errors in Book Value*
(in billions)

Type of Book Value Error	Lower Bound	Point Estimate	Upper Bound
Known misstatement	$ 3.265	$ 4.398	$ 5.531
Unsupported	0.721	1.823	2.924

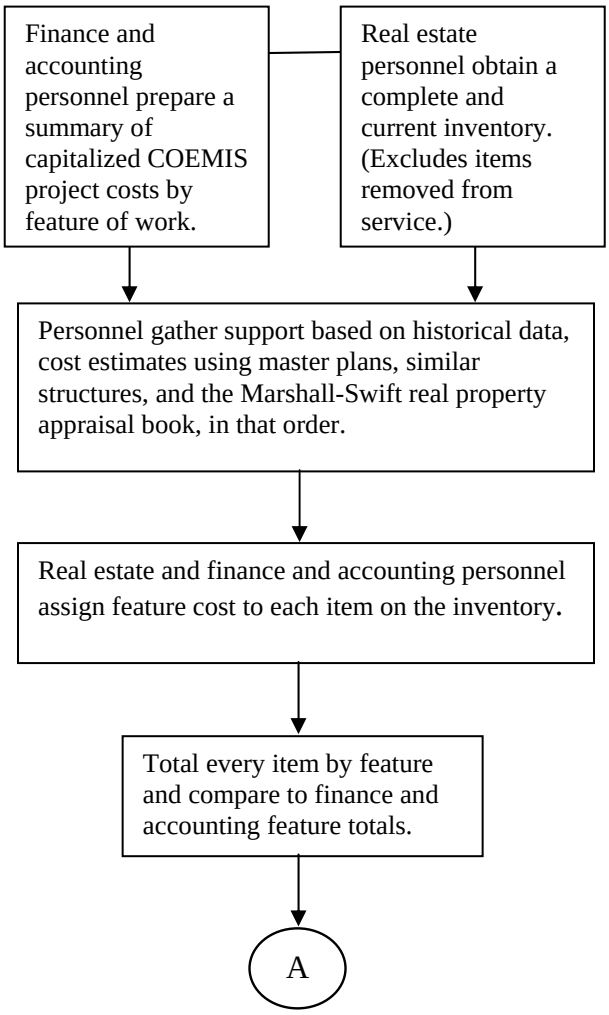
* Confidence level of 95 percent.

We are 95 percent confident that $3.3 billion to $5.5 billion in the book value of buildings and other structures was misstated as of June 30, 2003. Also, we are 95 percent confident that $0.7 billion to $2.9 billion in the book value of buildings and other structures could not be properly supported.

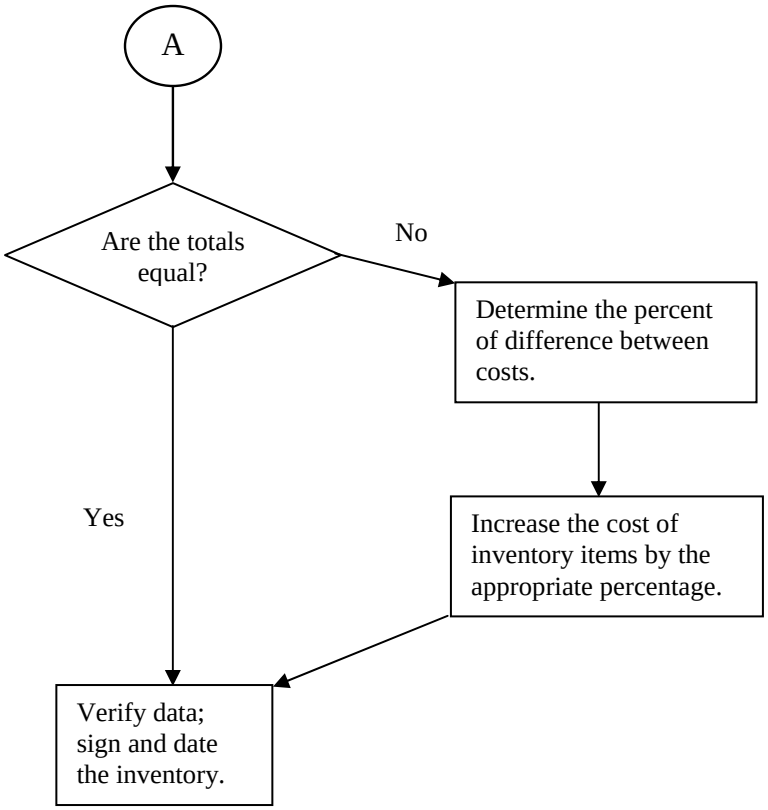
[5] There are two exceptions: the Richard B. Russell Dam, Georgia, and Bonneville Dam, Oregon, projects had six properties each with a book value of $25 million or more. The analysts included all those properties into the census stratum for the two projects.

Appendix F. COEMIS to CEFMS Conversion Process

USACE districts converted their financial records from COEMIS to CEFMS from 1994 through 1998. COEMIS tracked costs by feature codes such as land, dam, and recreational facilities. When USACE implemented CEFMS, the COEMIS costs were allocated to individual structures. USACE headquarters issued two memorandums: "Procedure for Reconciling Real Property Inventory With Accounting General Ledgers and Cost Records for Civil Works Projects," May 9, 1994, and "Procedures for Work Group Reconciliation of Real Property Inventory to Finance and Accounting Records," June 30, 1994, to assist districts in the reconciliation process. The following chart displays this process.



Appendix F. COEMIS to CEFMS Conversion Process (cont'd)



Appendix G. District Memorandum

We provided the 18 district commanders with a memorandum detailing the results of our work at each of their districts. An example of a district memorandum is in this appendix. Table G-1 lists the districts visited and the dates we issued the memorandums.

Table G-1. Districts Visited and Dates of Memorandums

District	Date
Nashville	August 13, 2004
Albuquerque	September 16, 2004
Omaha	September 16, 2004
Tulsa	September 16, 2004
Wilmington	September 16, 2004
Fort Worth	October 6, 2004
Mobile	October 6, 2004
Little Rock	October 25, 2004
Pittsburgh	October 25, 2004
Seattle	October 25, 2004
Huntington	November 1, 2004
Kansas City	November 1, 2004
San Francisco	November 1, 2004
Vicksburg	November 9, 2004
Walla Walla	December 17, 2004
Portland	February 22, 2005
Savannah	March 15, 2005
St. Louis	April 25, 2005

Appendix G. District Memorandum (cont'd)

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202–4704

September 16, 2004

MEMORANDUM FOR COMMANDER, ALBUQUERQUE DISTRICT, U.S. ARMY CORPS OF ENGINEERS

SUBJECT: U.S. Army Corps of Engineers, FY 2003 Civil Works, Financial Statements Buildings and Other Structures (Project No. D2004FI-0037)

Audit Update. The objective of this attestation engagement was to substantiate management assertions related to the buildings and other structures portion of the General Property, Plant, and Equipment (PP&E) balances on the U.S. Army Corps of Engineers (USACE), Civil Works, FY 2003 Financial Statements. As part of the engagement, the auditors examined evidence that supported the book cost and book value of a statistical sample of USACE structures.[1] The auditors will include the results cited in this memorandum in a series of audit reports addressed to USACE management.

Background. The auditor's work will be used to establish beginning balances for the audit of the Principal U.S. Army Corps of Engineers, Civil Works, Financial Statements for the Fiscal Years Ending September 30, 2004 and 2003. General PP&E was the largest category of assets reported in the USACE, Civil Works, FY 2003 financial statements. Structures comprised $18.3 billion of the $30.9 billion reported as General PP&E. Assertions are representations by management that are embodied in financial statement components. The assertions can be either explicit or implicit and can be classified according to the following broad categories.

- **Existence or Occurrence.** Assertions about existence or occurrence deal with whether the assets of the entity exist on a given date and whether recorded transactions have occurred during a given period.
- **Rights and Obligations.** Assertions about rights and obligations deal with whether assets are the rights of the entity on a given date.
- **Valuation or Allocation.** Assertions about valuation or allocation deal with whether asset components have been included in the financial statements at appropriate amounts.
- **Presentation and Disclosure.** Assertions about presentation and disclosure deal with whether particular components of the financial statements are properly classified, described, and disclosed.

[1] In the memorandum, the term "structures" includes buildings and other structures unless otherwise specified.

Appendix G. District Memorandum (cont'd)

- **Completeness.** Assertions about completeness deal with whether all transactions and accounts that should be presented in the financial statements are included.

Objectives. The overall objective of this attestation engagement was to verify the buildings and other structures portion of the general PP&E line item and related note disclosure to the FY 2003 Balance Sheet. The auditors also evaluated the accuracy and availability of supporting documentation for the sampled property identification codes reported in the Corps of Engineers Financial Management System (CEFMS) structures database as of June 30, 2003. In addition, the auditors evaluated the completeness of the data in CEFMS.

Scope and Methodology. To test the USACE management assertions of existence or occurrence, rights and obligations, valuation or allocation, and presentation and disclosure, the auditors statistically sampled transactions in the CEFMS structures accounts as of June 30, 2003. To avoid misstatement in more than one assertion, once a sample failed an assertion, the sample item was excluded from testing of the remaining assertions. To test the completeness of CEFMS, the auditors conducted reverse inventories of structures at the project sites and reconciled the inventories to CEFMS records.

The auditors conducted the audit at Cochiti Lake, located near Albuquerque, New Mexico, from October 28 through October 30, 2003. The auditors sampled 19 property identification codes that were identified within CEFMS as structures as of June 30, 2003.

Results. The following are the results of the testing of the 19 sample structures for each of the assertions. These results will be used to project any potential misstatement in the USACE structure accounts and identify recommendations for corrective actions.

Existence or Occurrence. To test the assertion of existence or occurrence, the auditors determined whether the 19 structures existed as of June 30, 2003, and whether recorded transactions related to structures occurred during the given period. The auditors conducted a physical inspection of each structure and observed whether structures were impaired or not in use. The auditors also determined whether the structures met the definitions of a building or structure and were properly classified in the accounting records. During existence and occurrence testing, we identified five assets that failed existence testing because four assets did not exist and one asset was impaired. As a result of these five existence assertion failures, the overall PP&E account was overstated by $1,185,410.51 in book cost and $795,295.93 in book value as of June 30, 2003. The following is our assessment.

- Three residence buildings (COCHIT-7045, COCHIT-7046, and COCHIT-7047) were removed from service between November 2001 and February 2002. Although the District Real Estate Division approved the assets for

disposal, the three structures had not been retired from CEFMS as of June 30, 2003. As a result, the book cost was misstated by $135,000.00, and the book value was misstated by $59,400.00, as of June 30, 2003. Furthermore, the assets were retired on October 3, 2003, with an inaccurate retirement date of June 1, 2001.

- A 23-mile road was recorded in CEFMS twice under the Property identification code COCHIT-6153 and COCHIT-5897. The cost of the road was being double counted, resulting in a book cost misstatement of $816,410.54 and a book value misstatement of $558,495.95, as of June 30, 2003.

- A 4-mile road (COCHIT-6154) was built primarily for the construction of the dam. The structure was impaired because it is usually submerged under water. Because the structure is no longer accessible, it should be retired. As a result, the book cost of the structure was misstated by $233,999.97, and the book value was misstated by $177,399.98, as of June 30, 2003.

Rights and Obligations. To test the assertion of rights and obligations, the auditors reviewed each sample item to determine if documentation existed to support the USACE rights to the structure as of June 30, 2003. Physical inspection of the structures and inquires determined whether the structures were being used by activities other than USACE and whether those activities have ownership of or rights to the structures. Based on observations and assessments of the data provided, none of the remaining 14 sample items failed the rights and obligations assertion.

Valuation and Allocation. To test for valuation and allocation, the auditors assessed the validity and support for each of the sample item's placed in service date and book cost. In the Memorandum of Agreement "Support for Recorded Book Cost of General Property, Plant, and Equipment Assets U.S. Army, Civil Works," June 9, 2004, the Office of Inspector General of the Department of Defense agreed to accept the conversion spreadsheet with a signed attestation statement as support for the book costs and placed-in-service dates of assets converted from the Corps of Engineers Management Information System to CEFMS. Also, the auditors assessed the propriety of a sample item's useful life by determining whether or not the asset should be considered USACE-unique or should comply with useful life standards contained in the DoD Financial Management Regulation (DoD FMR), volume 4, "Accounting Policies and Procedures," chapter 6, "Property, Plant, and Equipment," August 2000. Based on these assessments, the auditors recalculated the accumulated depreciation and book value (book cost less accumulated depreciation) of each of the sample items and reported the differences as a potential misstatement as of June 30, 2003.

Based on the auditor's observations and assessments of the data provided, 10 sample items failed one or more valuation tests. This resulted in a book cost misstatement of $124,207.29 and a book value misstatement of $13,903,719.57, as of June 30, 2003. The misstatement was caused by nine structures with incorrect useful

Appendix G. District Memorandum (cont'd)

lives and one structure with both an incorrect book cost and useful life. The following is the auditor's assessment.

- The conversion spreadsheets created during the conversion to CEFMS were used to support the book costs and placed-in-service dates for structures. However, a maintenance building (COCHIT-5879) had an addition and betterment in August 1999 that was not recorded in CEFMS. The auditors identified costs of $124,207.29 that was supported by third-party documentation and should have been reported in CEFMS.

- The useful lives of 10 sample structures were not in accordance with the DoD FMR. The DoD FMR identifies the useful life of buildings as 40 years and structures as 20 years. By assigning useful lives greater than those specified in the DoD FMR, the structures were depreciated over incorrect periods. As a result, the book values were misstated by $13,903,719.57, as of June 30, 2003. The following sample structures were inaccurately assigned useful lives of 50 and 100 years.

Property Identification Code	CEFMS Useful Life (Months)	DoD FMR Useful Life (Months)	Potential Book Value Misstatement
COCHIT-5877	1,200	240	$8,915,482.79
COCHIT-5878	600	480	$ 6,607.80
COCHIT-5879*	600	480	$ 14,397.12
COCHIT-5891	1,200	240	$ 291,333.37
COCHIT-5894	1,200	240	$ 52,332.33
COCHIT-5897	1,200	240	$3,989,970.07
COCHIT-5898	1,200	240	$ 93,375.00
COCHIT-6600	1,200	240	$ 288,333.37
COCHIT-7406	600	240	$ 242,043.97
COCHIT-7814	600	480	$ 9,843.75

*Includes the misstatement caused by an unrecorded addition and betterment.

- The utility structure (COCHIT-7406) was incorrectly classified as a building in CEFMS. On September 24, 2003, the district corrected changed the classification.

Presentation and Disclosure. To test for presentation and disclosure, the auditors reviewed the previously identified errors and determined how the errors affected the financial statements. The misstatements listed in the previous paragraphs misrepresent the balance of the PP&E line of the Balance Sheet and the buildings and structures line in the notes to the financial statement.

Appendix G. District Memorandum (cont'd)

Completeness. To test for completeness, the auditors conducted reverse inventory procedures at the field site visited. The auditors reviewed a random selection of 92 structures throughout the project and compared the Real Estate inventory with observations made at the field site. The following is the auditor's assessment.

- Eight structures were not reported in the real estate inventory or CEFMS. Because the district was unable to provide documentation, the district must take steps to accurately identify the book cost of these assets by conducting an appraisal. The structures that were not reported consisted of a group shelter, two gate attendant sites, and an overlook shelter at Tetilla Peak Park; five new vault toilets, three gate attendant sites, and a playground at Cochiti Park; and a sewage lagoon and an overlook shelter at Cochiti Lake.

- In addition, 157 assets were individual assets, such as picnic areas and campsites that should be grouped and totaled by like kind.

In addition, the auditors reviewed 10 out of 228 assets that were removed under the new capitalization and one asset that had a zero book value. The 10 assets were properly removed from CEFMS and the one asset with zero book value was accurately recorded.

Other Comments. District and project personnel were cooperative and helpful to our staff. They were able to quickly gather information and provide answers to inquiries. In addition, they were open to our recommendations. The auditors would like to commend the resource management and real estate staff, and especially Ms. C.J. Scussell, District Real Estate, and Ms. Debra Gallegos, District Resource Management, for their support during the audit. We would also like to thank Mr. Robert Garcia, Cochiti Lake Maintenance Supervisor, for cordially escorting us around the lake and Mr. Danny Hampton, District Internal Review, who did excellent work coordinating our meetings and visit. Any questions should be directed to Mr. George C. DeBlois (317) 510-3852 (DSN 699-3852) or Carmelo G. Ventimiglia (317) 510-3855 (DSN 699-3855).

Barbara A. Sauls

Barbara A. Sauls, CPA
Program Director
Financial Statement PP&E Division
Defense Financial Auditing
Service

cc:
Director, Resource Management, U.S. Army Corps of Engineers
Chief, Finance and Accounting Policy Division, U.S. Army Corps of Engineers
U.S. Army Corps of Engineers Internal Review Office
Commander, South Pacific Division, U.S. Army Corps of Engineers

Appendix H. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Assistant Secretary of the Army (Civil Works)
Commander, Corps of Engineers
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Non-Defense Federal Organization

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Subcommittee on Energy and Water, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
Senate Committee on Energy and Natural Resources
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Subcommittee on Energy and Water Development, Committee on Appropriations
House Committee on Armed Services
House Committee on Resources
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

U. S. Army Corps of Engineers Comments

DEPARTMENT OF THE ARMY
U.S. ARMY CORPS OF ENGINEERS
441 G ST. NW
WASHINGTON, D.C. 20314-1000

CEIR (36-2b) 14 Sep 2005

MEMORANDUM FOR Director, Defense Financial Auditing Service, Inspector General Department of Defense, 400 Army Navy Drive, Arlington, VA 22202

SUBJECT: Independent Examination of Valuation and Completeness of U.S. Army Corps of Engineers, Buildings and Other Structures. (Project No. D-2004-D000FI-0037.002)

The USACE response to each Department of Defense Inspector General (DoDIG) report recommendation follows:

Recommendations.

A. We recommend that the Chief of Engineers, U.S. Army Corps of Engineers:

A.1. Validate the implementation of the requirements contained in the Memorandum of Agreement, dated Jun 9, 2004, at each district. At a minimum, ensure that district offices:

Command response: CONCUR
USACE has updated the CFO Information Paper on Buildings and Other Structures outlining the requirements for acceptable supporting documentation agreed to in the MOA. In addition, in order to validate that the requirements are being followed the Corps has dispatched regional CFO teams to each District to ensure compliance. Completion date 31-Oct-2005.

a. Reconstruct the conversion spreadsheets for Cooper Dam and Ray Roberts Lake, Richard B. Russell Dam, Youghiogheny Lake and for any untested project sites that do not have conversion spreadsheets that comply with the requirements in the Memorandum of Agreement.

Command response: CONCUR
USACE has updated the CFO Information Paper on Buildings and Other Structures outlining the requirements for acceptable supporting documentation agreed to in the MOA. In addition, in order to validate that the requirements are being followed the Corps has dispatched regional CFO teams to each District to ensure compliance. During this review we will ensure the above mentioned projects have reconstructed their conversion spreadsheets. Completion date 31-Oct-2005.

b. Obtain additional supporting documentation for any structures initially recorded in the Corps of Engineers Financial Management System without a fully supported book cost. Expense the unsupported differences.

Command response: CONCUR
USACE has updated the CFO Information Paper on Buildings and Other Structures outlining the requirements for acceptable supporting documentation agreed to in the

MOA. In addition, in order to validate that the requirements are being followed, the Corps has dispatched regional CFO teams to each District to ensure assets are fully supported. Completion date 31-Oct-2005.

c. Maintain documentation in a readily available location for the required retention period.

Command response: CONCUR
USACE has updated the CFO Information Paper on Buildings and Other Structures outlining the requirements for acceptable supporting documentation being kept in a readily available place for the correct retention period. In addition, in order to validate that the requirements are being followed the Corps has dispatched regional CFO teams to each District to ensure compliance. Completion date 31-Oct-2005.

A.2. Direct a review of all book costs for buildings and other structures to ensure that only those costs needed to bring the assets to a condition and location suitable for its intended use are capitalized. Expense any maintenance and repair costs or costs that did not improve or extend the useful life of the building or other structure.

Command response: CONCUR
Each USACE District has been conducting a 100% review of all assets to ensure all cost associated with making an asset suitable for its intended use are capitalized. In addition, in order to validate that the requirement is being followed the Corps has dispatched regional CFO teams to each District to ensure compliance. Completion date 31-Oct-2005.

A.3. Direct district resource management offices to verify that the placed-in-service dates in the Corps of Engineers Financial Management System accurately reflect the dates the structures were complete and available for use. At a minimum, these reviews should ensure that the date, recorded in the Corps of Engineers Financial Management System is supported by the conversion spreadsheet or the completion date on the Engineer Form 3013.

Command response: CONCUR
USACE CFO Information Paper # 10 Buildings and Other Structures was updated to detail the process to verify the correct placed-in-service dates. In addition, in order to validate that the requirement is being followed the Corps has dispatched regional CFO teams to each District to ensure compliance. Completion date 31-Oct-2005.

A.4. Perform and document a comparison of the month available for service method and the midyear convention method of commencing deprecation. Determine the feasibility of implementing the midyear convention method if determined to be more beneficial.

Command response: CONCUR
HQUSACE has studied the feasibility of converting from the month available for service method to a midyear convention method and determined that since the method works as intended and is compliant to all regulations that

USACE focus on complying with current guidance. USACE will not be converting commencement depreciation methods. Complete 12-Sep-2005.

A.5. Develop a consistent and enforceable useful life policy for all buildings and other structures. Once developed, provide detailed training for establishing useful lives within the Corps of Engineers Financial Management System to district personnel and monitor compliance. At a minimum, the policy should:

Command response: CONCUR
USACE has worked with the field to establish a Corps Unique Useful Life table that was added to the Buildings and Other Structures CFO Information paper. USACE is submitting this list to OSD (C) for a waiver by 31-Aug-2005. The Corps of Engineers Financial Management System useful life table has been modified to adhere with the Corps Unique Useful Life Table. Estimated completion date 31-Oct-2005.

a. **Ensure that useful lives in Corps of Engineers Financial Management System are consistent for all buildings and other structures covered by the DoD Financial Management Regulation useful life tables.**

Command response: CONCUR
The Corps of Engineers Financial Management System has been modified to comply with the DoDFMR and Corps Unique Useful life tables. The field is completing a 100% review to ensure existing assets are in compliance to the appropriate useful life tables. Estimated completion date 31-Oct-2005.

b. **Establish useful lives for all unique structures for which a waiver is obtained from the Under Secretary of Defense (Comptroller).**

Command response: CONCUR
A list of Corps Unique assets useful lives will be submitted to OSD(C) for a waiver request from the DoDFMR. Estimated staffing action to be completed by 31-Aug-2005.

c. **Ensure that useful lives are consistently implemented and that documentation exists to justify any deviation from useful life policies.**

Command response: CONCUR
USACE CFO Information # 10 Buildings and Other Structures outlines guidance for the field to follow to become more unified in the useful life policies to include the requirement to justify any deviations from the tables. Estimated completion date is 31-Oct-2005.

A.6. Determine the feasibility of developing a system change in the Corps of Engineers Financial Management System that would automatically assign useful lives based on approved useful life tables.

Command response: CONCUR
The CEFMS Development Team is examining the practicality of the impacts of making the recommended change. Once their assessment is complete HQUSACE will make a decision as the to feasibility of such a change. Suspense date is 31 March 2006.

A.7. Review and reconcile the depreciation variance report on a monthly basis. Develop a report to calculate depreciation variances for buildings and other structures with additions and betterments.

Command response: CONCUR
Recommendation A7 of DODIG's Draft Report on Buildings and Structures (Project No. D2004-D000FI-0037.002), dated June 24, 2005, recommended a report be developed to calculate depreciation variances for buildings and structures with additions and betterments. A problem report below was submitted to review the current calculations on the Depreciation Verification Report to ensure the report was/was not calculating depreciation for additions and betterments correctly. The review of the report's calculation is reflected in the resolution of problem report 5234SLG01. Our review disclosed that the depreciation for assets with additions and betterments placed in service in CEFMS is being calculated properly. Completed 8 September 2005.

A.8. Correct the unresolved errors identified in the memorandums we sent to district commanders that detailed the results of our work.

Command response: CONCUR
Each Corps District who received a memorandum has corrected all errors.

A.9. Publish updated guidance that provides districts with detailed procedures to eliminate the valuation errors identified in the report. Once published, ensure that all personnel involved with asset management are trained on the updated procedures. Specifically:

Command response: CONCUR
Information papers have been used in the interim as a way to distribute updated policy to the field until the regulations and circulars will be updated. Estimated completion date 31-March-2006.

a. **Update Engineer Circular 405-1-2 to provide adequate guidance to ensure the accuracy of and support for a structure's book cost, placed-in-service date, and useful life.**

Command response: CONCUR
The Corps will incorporate the guidance reflected in the Real Property information paper into EC 405-1-2. Completion date is 31 March 2006.

b. Update the Engineer Regulation 37-1-30 to provide resource management personnel guidance that formalizes the corrective actions contained in Information Paper No. 10.

Command response: CONCUR
The Corps is in the process of revising ER 37-1-30 to incorporate all of the guidance provided in all of the asset related information papers. Suspense date is 31 March 2006.

B. We recommend that the Chief of Engineers, U.S. Army Corps of Engineers:

B.1. Immediately resolve the 147 completeness errors identified in the district memorandums.

Command response: CONCUR
The list of 147 completeness errors has been provided to each Corps District and they have made all corrections.

B.2. Direct districts to complete a one-time, wall-to-wall inventory of the structures at the project sites. Adjust the Corps of Engineers Financial Management System to reflect inventory results.

Command response: CONCUR
The requirement to do a 100% review every three years on every real property asset in the Corps is outlined in information paper #10 on Buildings and Other Structures. To ensure compliance the Corps has dispatched regional CFO teams to validate the inventory is correctly reflected on USACE books. Completion date is 31 October 2005.

B.3. Develop a policy for the proper capitalization of principal structures and integral components. Ensure that the integral components established as separate property identification codes remain capitalized as part of the principal structure.

Command response: CONCUR
USACE is using CFO Info paper # 10 Buildings and Other Structures to adjust current written guidance to quickly advise the field to clarify inconsistencies until the appropriate written guidance can be updated. The field is currently assessing all projects identifying which assets are stand-alone principal structures, and which assets are integral components of the project that should also be barcoded and capitalized. Estimated completion date is 31-Oct-05.

B.4. Review structures recorded with zero book value and ensure that the structures are properly valued after making any necessary adjustments in the useful lives and placed-in-service date required by new U.S. Army Corps of Engineers guidance. Give special attention to any district reporting all its buildings and other structures as fully depreciated.

CEIR (36-2b) 14 Sep 2005
SUBJECT: independent Examination of Valuation Completeness of U.S. Army Corps of Engineers, Civil Works, Buildings and Other Structures
(Project No. D-2004-D000FI-0037.002 Issued date: 24-Jun-2005)

Command response: CONCUR
A full asset review is underway in the field. The Corps has dispatched regional CFO teams to each District to ensure compliance. Completion date is 31-Oct –2005.

B.5. Direct district personnel to review their structures in the Corps of Engineers Financial Management System and ensure that:

a. Grouped structures assigned to a single property identification code comply with Engineer Circular 405-1-2, and any exceptions are justified. Assign individual property identification codes to individual structures that have been erroneously grouped together. If the individual book cost of the formally group structures falls below $ 25,000 threshold, remove the structures from the financial records.

Command response: CONCUR
CERM-F is currently reviewing the grouping procedures followed by USACE and evaluating the cost benefits and feasibility of implementing guidance to districts to ensure all asset groups are valid and meet current threshold requirements, those that do not meet the test shall be removed from CEFMS. Completion date 31-March-2006

b. Each property identification code represents a tangible structure. For property identification codes that represent unassigned costs, allocate the costs to the proper structures or expense them.

Command response: CONCUR
A 100% review is being conducted by the field on all assets to ensure compliance with current policy described in info paper # 10 Buildings and Other Structures. The Corps has dispatched a regional CFO team to each District to ensure compliance. Estimated completion date 31-Oct-2005.

c. Structures can be positively identified by either placing the property identification on the structure or through use of alternative methods, such as Global Positioning System technology.

Command response: CONCUR
USACE field activities are fully documenting and properly identifying each asset using all available and appropriate means (GPS, spray-paint, plaques etc.) as necessary. Completion date 31 October 2005.

The POCs for this response are Edsel Fraley (202) 761-0549 and Donna Johnson (202) 761-8518.

FOR THE COMMANDER:

6

CEIR (36-2b) 14 Sep 2005

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for DONALD J. RIPP
Chief, Audit Executive
U.S. Army Corps of Engineers

7

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