During an exit conference of March 28, 1988, the U.S. Embassy's General Services Officer generally agreed with the findings and agreed to consider and implement all twenty recommendations. Therefore no further recommendations are required.

UNITED STATES GOVERNMENT

memorandum

DATE: April 14, 1988

REPLY TO ATTN OF: William C. Spat, RIG/A/Cairo (A)

SUBJECT: Review Of The American Embassy In Cairo Internal Controls Relating To Property Management

TO: Ambassador Frank G. Wisner, American Embassy in Cairo
Mr. Marshall D. Brown, Director USAID/Egypt

The attached report dated April 5, 1988, by Price Waterhouse of Egypt presents the results of the internal control review made for the American Embassy in Cairo. The review related specifically to the management of State Department nonexpendable property. The nonexpendable property inventory consists of more than 24,000 items with a value in excess of $5 million. The review was requested by the U.S. Embassy's General Services Officer in light of recent disclosures of improprieties with respect to the safeguarding of Embassy property.

The review was done to: (a) document the current system of internal control relating to requisitioning, receiving, warehousing, transferring and disposing of nonexpendable property; (b) determine the adequacy of the documented controls; and (c) make specific recommendations for improvements to the system of internal control.

This report provides flow charts and descriptions of the primary property management functions of requisitioning, receiving, and property disposal. Descriptions of property movements, record keeping and other procedures are also provided. The review disclosed a marginally adequate system of internal control that needed improvements to strengthen the safeguarding of nonexpendable property and to make property management operations more efficient.

The report contains twenty specific recommendations. Significant improvements in organization, cleanliness, and physical layout of the warehouse facility have taken place during the review. Some of the twenty detailed recommendations of this report may therefore no longer be required, but were included for reference purposes only.

OPTIONAL FORM NO. 10
(REV. 1-80)
GSA FPMR (41 CFR) 101-11.6
5010-114

During an exit conference of March 28, 1988, the U.S. Embassy's General Services Officer generally agreed with the findings and agreed to consider and implement all twenty recommendations. Therefore no further recommendations are required.

TELEGRAPH
CAIRO C R

Price Waterhouse

RNL/ 276 oa.

April 5, 1988

Mr. Joseph R. Ferri
Mr. Leonard Deege
RIG/A/C
USAID/Egypt
106 Kasr El Aini Street
Cairo, Egypt

Dear Sirs,

Re: OTR-0000-I-00-6168-00, Work Order No. 05

In accordance with the above referenced contract, we are hereby submitting our final report for the internal control review conducted for the U.S. Embassy relating to property management. An executive summary highlighting areas of significance is included as Section I. Section II contains an overview of the Embassy, as well as a description of the internal control process and the approach we followed in conducting this engagement. Section III of our report contains the testing methodology followed and corresponding test results. Section IV presents recommendations and findings resulting from our work. Flow charts and other useful reference material are presented as exhibits.

We would like to thank you and the Embassy staff for the assistance and cooperation provided throughout our review. The participation of Embassy personnel has added significantly to the completeness of our report. We look forward to assisting you in the future.

Yours very truly,

Afifi H. Shahawi

Afifi H. Shahawi

Encls: As stated.

TABLE OF CONTENTS

		Page
I.	EXECUTIVE SUMMARY	1
II.	INTRODUCTION	
	A. Embassy Overview	2
	B. What is Internal Control	2
	C. Scope and Methodology	3
III.	TESTING	
	A. Receipt of Nonexpendable Property	5
	B. Control of Nonexpendable Property Movements and Maintenance of Property Records	6
	C. Disposal of Nonexpendable Property	6
	D. Other Procedures	7
IV.	FINDINGS AND RECOMMENDATIONS	
	A. Overall Finding	8
	B. Specific Recommendations and Findings	
	1. Receipt of Nonexpendable Property	9
	2. Control of Nonexpendable Property Movements and Maintenance of Property Records	10
	3. Disposal of Nonexpendable Property	14
	4. General	15
V.	EXHIBITS	
	A. Flow Charts	
	B. Effective Internal Control	
	C. Comptroller General's Internal Control Standards	
	D. Photographs	

E

I. EXECUTIVE SUMMARY

We performed a limited review, applying only certain procedures to the system of internal controls surrounding nonexpendable property management at the U.S. Embassy in Cairo. Our work was performed at the request of the Regional Inspector General for Audit in connection with perceived weaknesses in the system of control.

Our objective was to document the current system of internal control relating to requisitioning, receiving, warehousing, transferring and disposing of nonexpendable property. Another objective was to determine the adequacy of the controls documented and make specific recommendations for improvements to the system of internal control. The results of our testing indicated that certain improvements should be made to the system of internal accounting control. Specific recommendations were developed in numerous areas and included, among others, recommendations to change the physical arrangement of the warehouse, improve detailed record keeping, make changes in the source documents used to update property record cards, develop a comprehensive policy and procedures manual, and perform periodic compliance testing.

In summary, the system is only adequate and for such a system to properly safeguard assets, it is essential that all controls are adhered to strictly.

II. INTRODUCTION

A. Embassy Overview

The United States of America Embassy in Cairo with its components of economic and military assistance to Egypt is now one of the largest of all U.S. Embassies. Since 1974, when diplomatic relations with Egypt were resumed, the staff of the Embassy has grown from approximately 30 Americans and 95 Egyptians to over 500 Americans and 1,200 Egyptians. Including family members the Embassy comprises over 1,200 Americans.

The Embassy owns numerous pieces of real estate in and around Cairo including three apartment complexes; one in Zamalek and two in Maadi. Flats in these complexes are provided to certain Embassy employees and are completely furnished by the Supply and Property Management (SPM) group of the Embassy. SPM is staffed by a combination of a few Americans in supervisory roles assisted by Egyptians and is responsible for the receipt, control and maintenance of nonexpendable property and other related property services. The nonexpendable property inventory in Cairo is composed of over 24,000 items with a value in excess of $5 million. Our limited review of the system of internal control focused on State Department nonexpendable property that the SPM group administrates and was performed as a result of perceived weaknesses identified by management.

B. What Is Internal Control

The U.S. General Accounting Office, in prescribing standards for Internal Controls in the Federal Government, States that "Good internal controls are essential to achieving the proper conduct of Government business with full accountability for the resources made available. They also facilitate the achievement of management

objectives by serving as checks and balances against undesired actions. In preventing negative consequences from occuring, internal controls help achieve the positive aims of program managers".

Internal controls should not be looked upon as separate systems within an agency. Rather, they should be viewed as an integral part of each system that management uses to manage its operations. In this sense internal controls are really management controls. For internal controls to be effective, government officials should ensure that they have established an environment that creates the appropriate control awareness, attitude and discipline and that each control system: fits the organization and its operating philosophy, focuses on areas of inherent risk, and achieves a thoughtful balance between control costs and benefits.

C. Scope and Methodology

1. Statement of Work

The scope of our work covered the areas identified in Article III - Statement of Work of our contract and related exclusively to State Department nonexpendable property. We organized our review according to the following functions:

- Receipt of nonexpendable property
- Control of nonexpendable property
- Disposal of nonexpendable property

Through extensive interviewing and walk-throughs, we identified event cycles for the functions listed above. These event cycles were flowcharted and existing controls highlighted. We then developed control objectives and suggested control techniques to correspond with the event cycles. Within these functions, we selected key controls to be tested. The final step in our review was to develop findings and recommendations based on the scope of work.

A narrative explanation of certain of our significant tests is included as Section III of this report. Findings and recommendations are presented in Section IV.

2. Timing

The on-site work was conducted from February 15, 1988 to March 21, 1988. All on-site work was performed at the U.S. Embassy and Maadi Warehouse in Cairo. A draft of this report was presented to Embassy and RIG/A officials on March 23, 1988 and was discussed on March 28, 1988; all substantive comments have been incorporated in this final report.

III. TESTING

Specific means of testing the control techniques were developed in order to evaluate their performance under operating conditions. Our testing followed the format below:

- Select controls to be tested.
- Select test methods.
- Determine number of records to be tested and sample selection criteria.
- Conduct the test.
- Document test results.

In addition, a significant portion of our review involved walkthrough procedures, interviews of Embassy personnel and observations made during our numerous visits to the property warehouse. Certain of our significant tests are explained below. Recommendations relating to noted deficiencies are included in Section IV.

A. Receipt of Nonexpendable Property

We spent a day at the warehouse in the receiving department observing receiving employees in action. We witnessed the opening of packages, completion of receiving reports, and matching of receiving reports with purchase orders. We then judgementally selected 10 receiving reports prepared during the previous 12 months and reviewed each document noting proper approvals and ultimate matching with the purchase order.

B. Control of Nonexpendable Property Movements and Maintenance of Property Records.

We toured the warehouse noting location and condition of the nonexpendable property in storage. We made 50 test counts of assets in the warehouse and agreed such counts to the property record cards. We also selected 50 items recorded on the property record cards and physically verified their existence in the warehouse. The results of these procedures were generally satisfactory except we noted the property record cards were not updated on as timely a basis as possible. We then selected 25 property record cards for appliances located in personal residences and determined that the property exists by tracing the items to the most recent count sheets. All samples of documents tested were selected on a judgemental basis and represent a small percentage of the total population.

Additionally, we reviewed the physical inventory reconciliation dated October 29, 1987 and supporting detailed work papers. We noted numerous underages and more importantly overages of property, which indicates a general lack of integrity of the property record cards. Further, we did not note significant follow-up of the inventory discrepancies.

C. Disposal of Nonexpendable Property

We inspected the property waiting disposal via auction stored on the roof of the warehouse. We judgementally selected 12 property disposition authorization forms and reviewed them for appropriate approval and traced the disposition to relief on the respective property record card.

D. Other Procedures

We observed Nonexpendable Property Application (NEPA) count teams tag and record the contents of three separate personal residences, noting the method of assigning codes, and estimating remaining lives and values of the property.

We also reviewed SPM procedures for general compliance with FAM 6.

IV. FINDINGS AND RECOMMENDATIONS

A. Overall Finding

The control environment of the U.S. Embassy nonexpendable property system requires improvement. Our limited testing indicates the overall design of the system to be merely adequate. For such a system to function properly and safeguard assets, it is essential that all controls are adhered to strictly. Our tests of compliance with the various controls did not reveal significant deviations. However, it is important to note that no system can provide absolute assurance that irregularities will be detected. During the course of our review we did not note any items that we considered to be a material internal control weakness, but rather, numerous situations that when taken as a whole might result in a lack of internal control. The following recommendations relate to areas where we believe controls could be improved and operations made more efficient. Our recommendations are the result of applying only certain tests to the system of control, had we conducted additional tests other weaknesses may have been detected.

B. Specific Recommendations and Findings.

We are pleased to report significant improvements in the organization, cleanliness, and physical layout of the warehouse facility have occurred since we commenced our review. As a result certain of our recommendations may now be considered redundant but are nevertheless included for reference purposes. The recommendations following are numbered with alpha-numeric characters that correspond to each of the categories below.

1. Receipt of Nonexpendable Property

RECOMMENDATION 1a:

Move the receiving department at the warehouse to the ground floor in close proximity to where goods are unloaded and appropriately secure the area.

Presently the receiving department is located on the third floor of the warehouse across from the offices. During our visits to the warehouse we noted the area devoted to receiving is inadequate and that goods awaiting check-in were stacked in the hallways. These conditions do not allow for effective internal control or physical safeguarding of the assets. The receiving department should be located on the ground floor near where the trucks are unloaded and should be secured by chain-link fence or other barrier. Access to other storage areas of the warehouse should also be restricted. We are pleased to note the changes recommended above are already being implemented.

RECOMMENDATION 1b:

Receive all goods at the warehouse in Maadi.

During our review of the inventory reconciliations we noted a disturbing number of overages. Management attributed overages to goods which had been received at Embassy locations other than the warehouse and therefore, not recorded in the property records. We recommend all goods be recieved at one central point, the Maadi warehouse. We do recognize that certain items must be shipped directly to the users. These rare cases should require the approval of the Accountable Property Officer. We further recommend that the Financial Management Center ascertain that SPM has approved all receiving reports prior to payment of the invoice. Such procedures would eliminate instances where assets are received at remote locations and related invoices paid without the knowledge of SPM. This will insure that all assets are included in the property records when purchased.

RECOMMENDATION 1c:

Analyze, in coordination with procurement, open purchase orders on a monthly basis and determine if certain long outstanding purchase orders should be cancelled.

During our discussions with receiving and warehouse personnel we noted there were an inordinate number of open purchase orders that create confusion upon the receipt of goods. We recommend that the open purchase order file be reviewed monthly in order to lessen the disorder concerning which receipts relate to which purchase orders. Such a task, while initially time consuming, would eventually involve little effort on a monthly basis and would significantly enhance the control environment and reduce the possibility of "kiting" or "lapping" purchase orders.

2. Control of Nonexpendable Property Movements and Maintenance of Property Records

RECOMMENDATION 2a:

Eliminate composite property record cards and include more information, such as location, on the detail record cards.

Through our observations and detailed tests of property record cards we noted that, due to the lack of information on composite property record cards, they provide little control over the asset and are ineffective in the inventory reconciliation process. We recommend the composite property record cards be eliminated and replaced with detailed cards including asset type, serial number, date of purchase, color, etc, and location. We view location as an important piece of information as it provides an important control element for the asset. We further recommend that property record cards be filed by flat and then by asset type. Given the nature of the

Embassy's operations, it is apparent that each flat (location) is a better control point than each asset type. It would be easier, in our opinion, to maintain control locations containing a given number of assets rather than control numerous types of assets spread throughout Cairo.

We understand the new Nonexpendable Property Application system, when implemented, will alleviate most of the ineffeciencies associated with composite property record cards. The new system will provide a detailed computer data base of individual nonexpendable property items and can be manipulated to produce information in a variety of forms suitable for reconciliation and other analysis.

RECOMMENDATION 2b:

Update property record cards based on the sequentially numbered government property passes.

Presently the request form is the source document that triggers entries (other than the original purchase and final disposition) to the property record cards. The documents are not sequentially numbered and SPM personnel have no means of determining that property record cards are updated for all transactions.

The government property pass serves as the source document authorizing movement of assets in and out of the warehouse yard. We recommend that SPM match the government property passes with the request forms and attach the documents, filing them in a numerical file based on the prenumbered property pass forms. Together the documents would serve as the source document for updating the property record cards and insure that all movements are reflected in the underlying records.

RECOMMENDATION 2c:

Investigate book to physical inventory differences in a detailed manner and on a timely basis.

During our review of the inventory reconciliation we noted shortages of $ 33,477 and 149 items and overages of $ 261,434 and 1,358 items of a total recorded inventory of $ 5,195,435 and 24,046 items. Meaningful investigation is difficult due in part to the condition of the property records (see recommendation 2a). The differences were recommended for immediate write-on or write-off of the records. We recommend that inventory differences be thoroughly investigated. A comprehensive review of overages and shortages is important as it may point to indications of weaknesses in the system of internal control.

We also recommend that assets stored in the warehouse be subject to cyclical inventory counts in addition to the annual inventory. Such cyclical counts, made only of certain assets, would enhance control over goods at the warehouse.

RECOMMENDATION 2d:

Establish the Maadi warehouse as the central control point. Assets should be transfered only to and from the warehouse rather than between remote locations.

We noted numerous instances where property was transferred between remote locations. While such movement may be convenient it may also lessen effective control over the physical safeguarding of the asset. By establishing the warehouse as the central control point and each flat as a subsidiary location, physical control of the asset is enhanced and the likelihood of misappropriation is reduced.

RECOMMENDATION 2e:

Prepare a reconciliation of current year additions and disposals that can be compared with the final physical inventory.

A reconciliation should be prepared that combines the prior year ending inventory balances with current year purchases and disposals. This reconciliation can then be compared to the physical inventory. A reconciliation of this sort, especially when done on an inventory item basis, would be helpful in explaining book to physical inventory overages and shortages.

RECOMMENATION 2f:

Update property record cards on a timely basis for asset additions, transfers and disposals.

During our review of property record card activity we noted the timeliness of postings could be improved. In one case, three months had elapsed from the transaction date until the posting date. In other cases the time lag was not as severe, generally about one month. Optimally all activity should be posted the following business day, however, we recognize practical limitations and recommend that all activity be posted within one week. Such a policy would provide greater assurance that the correct transactions are posted and would enhance the integrity of the records.

3. Disposal of Nonexpendable Property

RECOMMENDATION 3a:

Store assets held for disposition in a space protected from the elements.

During our tours of the Maadi warehouse we noted that assets held for disposition were stored on the roof of the building. The assets included many electrical appliances and office machines as well as furniture and mattresses that are easily damaged and their value diminished by exposure to rain, sand and sun. We suggest that all assets be stored in suitable space protected from the elements.

We are pleased to report that management has begun construction of an appropriate storage area for assets pending disposition.

RECOMMENDATION 3b:

Compare the asset's age with expected useful life during the decision to dispose process and require second opinions if the asset is not in the last 25% of its life.

Our review of property disposition authorization forms indicated that many assets were declared uneconomical to repair well in advance of the end of their estimated useful life. This condition may suggest that usable assets are being disposed of prematurely. We recommend that the Accountable Property Officer obtain a second opinion, independent of Building and Grounds Maintenance, for any asset proposed for disposition prior to the last quarter of its estimated useful life.

We also recommend that a new form be completed by the technician who recommends an asset for disposal. Such a form would effectively document the reasons for disposal and could highlight abuses of authority by Building and Grounds technicians.

4. General

RECOMMENDATION 4a:

Develop and write a detailed procedures manual for property management within the framework of FAM 6.

Presently Supply and Property Management does not have a written, detailed procedures and policy manual but rather operates on the basis of undocumented procedures developed over time. Confusion concerning actual procedures and policies was evident during the course of our review and during preparation of system flowcharts. We recommend a detailed procedures manual be developed within the broad guidelines of FAM 6 and custom tailored to the requirements of the U.S. Embassy in Cairo. A written procedures manual is required by Section 223.1 of FAM 6 for the receipt and inspection of property and we believe a procedures manual documenting the entire system of property management would be appropriate.

RECOMMENDATION 4b:

Subject the services property management group records to annual external compliance review.

Current procedures do not provide for any periodic compliance reviews of SPM's property records. An annual external compliance review could be obtained at a modest cost and would identify potential weaknesses and problem areas before controls are compromised and the integrity of the records is impacted. Such a review would provide an extra incentive to maintain accurate records and could

include tests of receiving reports, property records, and property disposition authorizations. A review of this nature by the Accountable Property Officer, including spot checks and other analysis as appropriate, is required by section 223.5e of FAM 6 and has not been performed in the past.

RECOMMENDATION 4c:

Reduce the number of governmental organizations sharing space at the Maadi warehouse.

Presently in addition to Supply and Property Management the following groups occupy space at the warehouse: United States Agency for International Development, American Employees Cooperative and Welfare Association, Office of Military Cooperation and Building and Grounds Maintenance. Due to the numerous groups sharing space at the warehouse there are an inordinate number of people who are granted access to the property. We recommend that the number of groups sharing space be reduced. In fact, it may be appropriate to consider alternative warehouse space since the current warehouse is not really designed as a warehouse and is inefficient for SPM's operations.

RECOMMENDATION 4d:

Improve security at the warehouse.

Through our observations we noted security at the warehouse was generally adequate but required improvement in several important areas. The warehouse is surrounded by a fence, but given its location and the proximity to the canal and other businesses we believe that barbed wire should be placed along the top of the wall in all areas.

Access to the warehouse is limited to a front and rear gate. Security at these points should be strengthened. Price Waterhouse and RIG/A personnel observed a truck passing through the rear gate without any apparent security checks. In addition, the guards at the front gate admitted Price Waterhouse staff on two occassions and RIG/A staff on one occasion without proper authorization identification cards.

We recommend security measures be tightened at the warehouse yard, barbed wire should be installed along all areas of the fence, the rear gate should be removed and replaced with a suitable fence, and the security guards should ascertain the identity of all who seek admittance to the yard as well as inspect the contents of all vehicles coming and going.

RECOMMENDATION 4e:

Periodically survey property to ensure it provides maximum benefit and is used only for official purposes.

During the course of our testing we did not note any evidence of such a review being performed. Section 222.7-1b of FAM 6 requires the Accountable Property Officer to make at least semi-annual surveys documenting that property is used to its potential and for government purposes. An important part of this assessment would be to review inventory volumes and identify surplus and obsolete stock. We recommend compliance with this requirement in the form of a memorandum to the files.

RECOMMENDATION 4f:

Require employees to sign a formal conflict of interest policy.

Our tests and observations led us to believe that certain employees, particularly those in the maintenance area, may have outside business interests that are not entirely compatible with their functions in property management. Employees should sign a formal conflict of interest policy at the time of employment and again on an annual basis.

RECOMMENDATION 4g:

Adopt a formal anti-nepotism policy within the property management area.

Certain of our observations and procedures lead us to believe that sets of related persons are working within different areas of property management. While nepotism in and of itself does not necessarily indicate a lack of internal control, it does provide for a greater potential of lack of segregation of duties. A formal anti-nepotism policy would help insure that there is the necessary independence to provide for effective internal control.

RECOMMENDATION 4h:

Consider using metal tags when marking the assets with NEPA numbers.

We accompanied a NEPA (Nonexpendable Property Application) count team and observed their physical inventory of three residences . We noted count teams applied numbered plastic stickers to all assets and then recorded a description on the count sheet for later entry to the system. Upon review we noted that many of the plastic tags did not adhere satisfactorily to the assets and recommend the use of rivoted metal tags be considered to insure that the identification number remains attached to the asset.

RECOMMENDATION 4i:

Rotate members of the service team such that each technician works with a variety of other maintenance personnel during the course of the year.

Through our observations, we noted that there was no specific policy regarding the rotation of members on each service team. Such a policy would be beneficial in exposing technicians to new methods and procedures used by their co-workers and prevent detrimental relationships from forming that are not in the best interests of effective internal control.

Exhibit A

Requesting Procedures
Flow Chart Explanations

1. The applicable party makes a request for property. A five part form is completed.

2. The Accountable Property Offices grants reasonable requests based on availability of property.

3. A goverment property pass is signed by an authorizing SPM officer allowing the property to pass the warehouse security gate.

4. The property is transported and installed after completion of any necessary maintenance.

5. Copies of the request form are distributed to various departments.

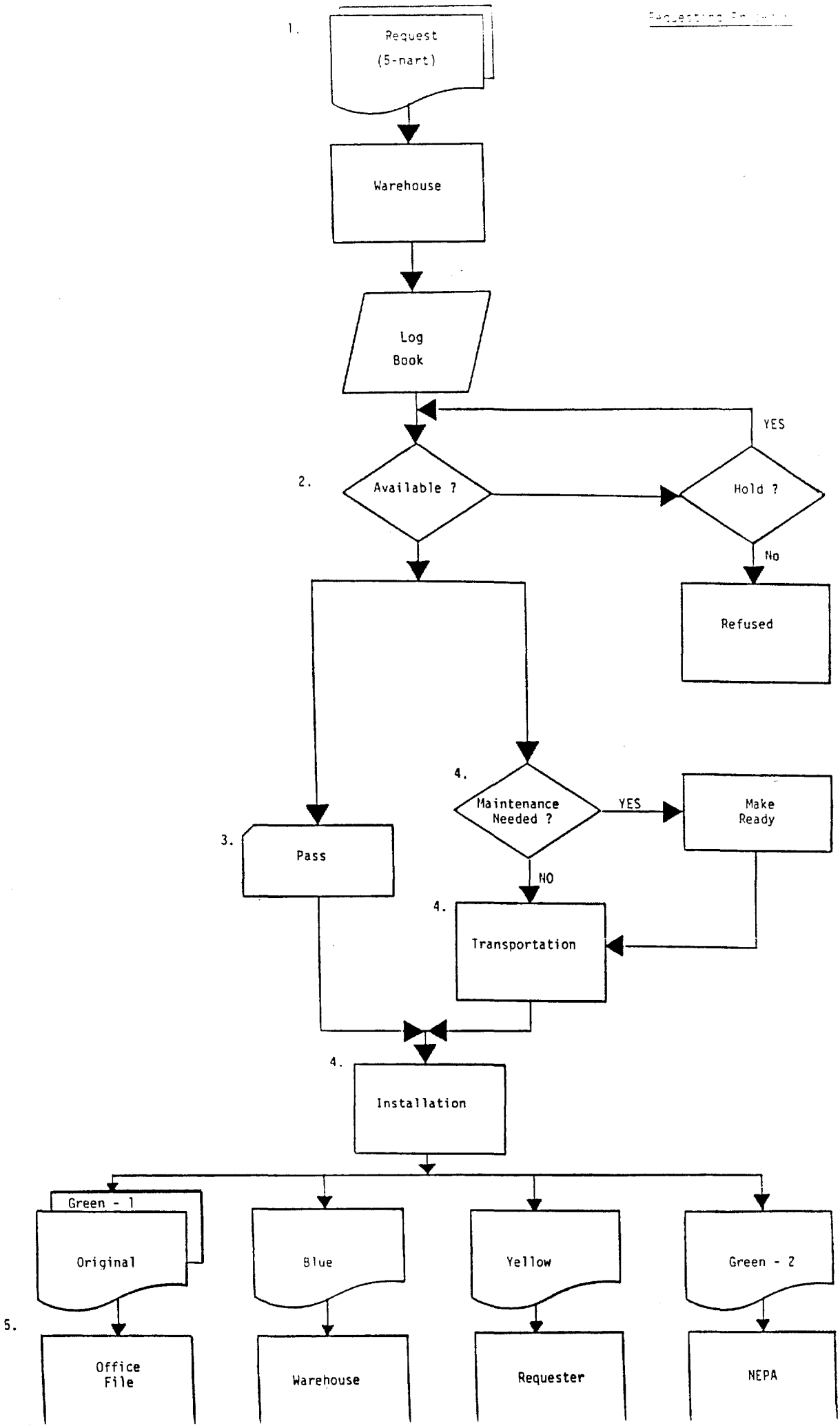

1.
Request
(5-part)
Warehouse
Log
Book
YES
2.
Available ?
Hold ?
No
Refused
4.
Maintenance
Needed ?
YES
Make
Ready
3.
Pass
NO
4.
Transportation
4.
Installation
Green - 1
Original
Blue
Yellow
Green - 2
5.
Office
File
Warehouse
Requester
NEPA

Exhibit A

Receiving Procedures
Flow Chart Explanations

1. Procurement department issues an eight part purchase order (approved by Procurement Officer).

2. Financial Management Center approves the purchase order if funds are available.

3 Copies of the purchase order are distributed to various departments.

4. The vendor copy prompts shipment; items are cleared through travel, shipping and customs and received at the warehouse by the Receiving Clerk.

5. Goods are received, counted and a 5 part receiving report is completed including the following:

-Receiving Clerk comments	-item description
-serial number (if applicable)	-receiving dept. signature
-purchase order number	-receiving report number

6. The Receiving Department Supervisor compares the receiving report to the packing list and the accountable property officer signs the receiving report after examining the items received.

7. The items are forwarded to the requester or the warehouse and the receiving report is signed by the respective recipient.

8. The receiving report is distributed to various departments.

9. A xerox copy is provided to the SPM office and the property records are updated.

Receiving Procedures

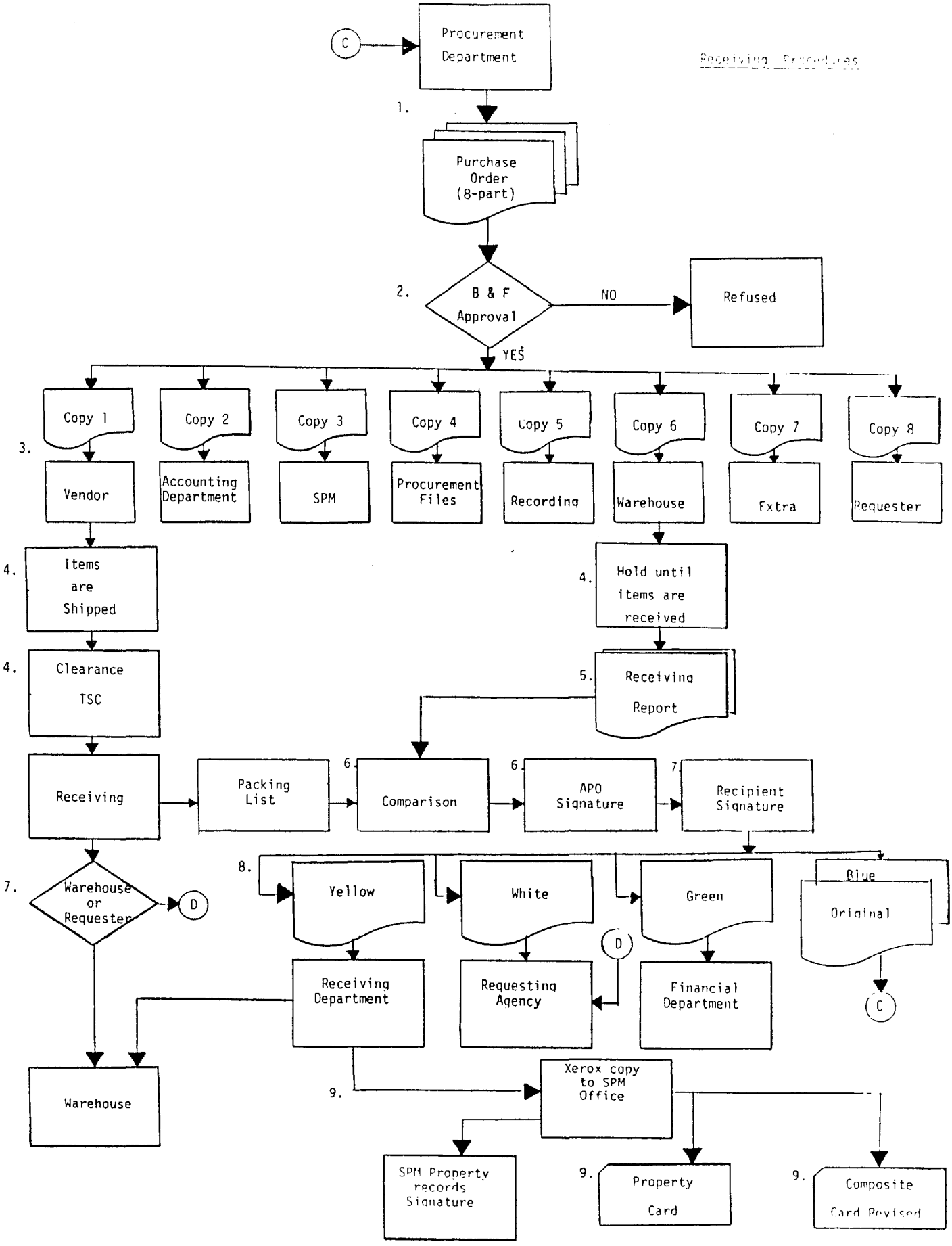


Exhibit A

Disposal Procedures
Flow Chart Explanations

1. Building and Grounds technicians advise SPM that appliances should be sold. The Accountable Property Officer provides SPM and Procurement a disposal list.

2. Items on the disposal list are traced to Property Record Cards as applicable.

3. The Property Disposal Authorization is signed by the Accountable Property Officer and the Property Management Officer.

4. The property is grouped for sale by lots by the Auction Specialist and bid sheets are prepared listing lot numbers grouped by agency.

5. The bidders are provided a bid package comprised of an invitation, terms of sale and bid sheets.

6. The bids are opened by the procurement office employees; the results are summarized and posted at the auction site.

7. The winner pays for the goods and a three part bill of sale is completed.

8. The bill of sale is distributed and the property is delivered.

Disposal Procedures

(page 1 of 2)

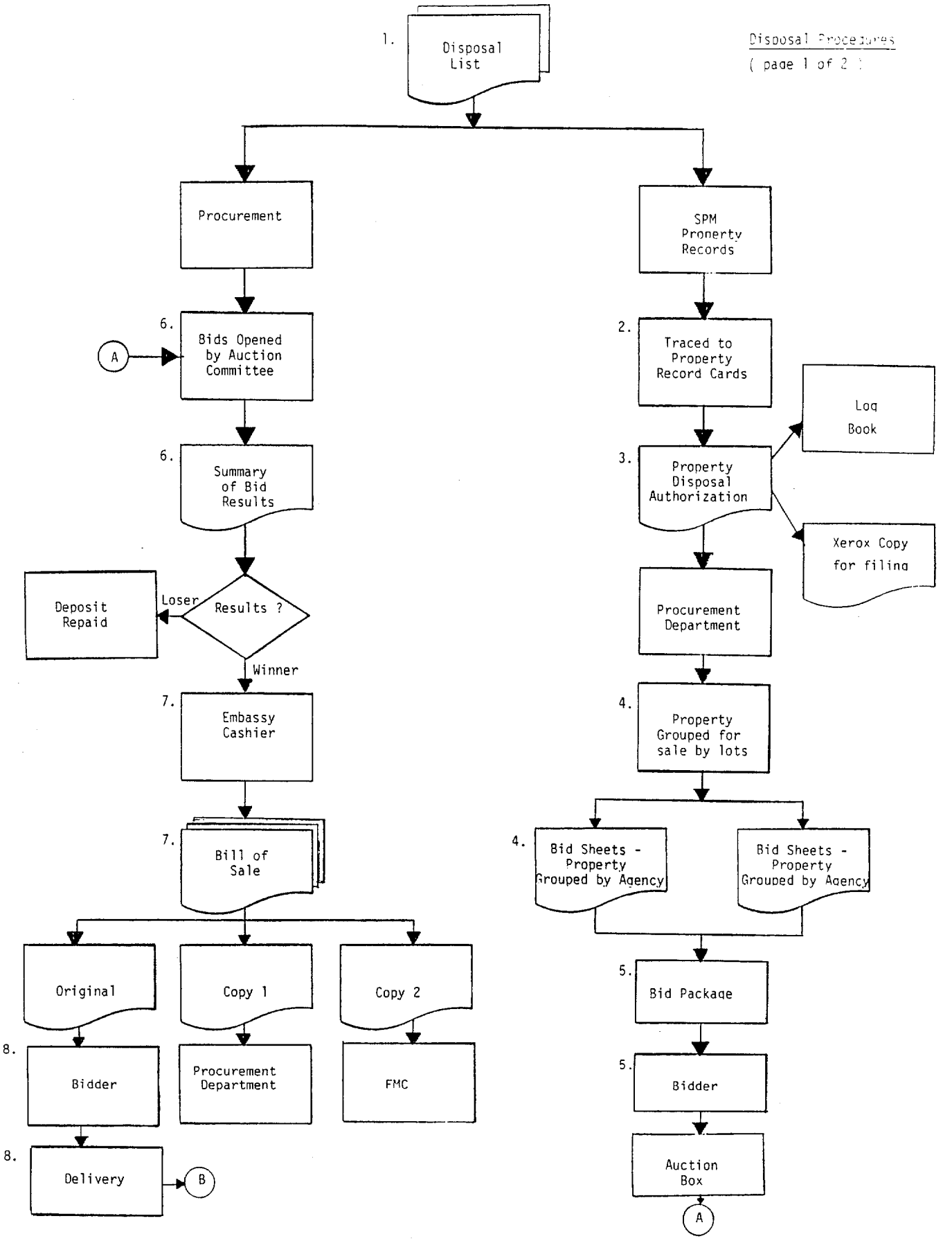


Exhibit A

Disposal Procedures

Flow Chart Explanations (cont.)

9. Auction proceeds are summarized and a formal memo is provided.

10. The Property Disposal Authorizations are signed by the Disposal Officer.

11. The Property Record Cards are updated.

Disposal Procedures

(page 2 of 2)

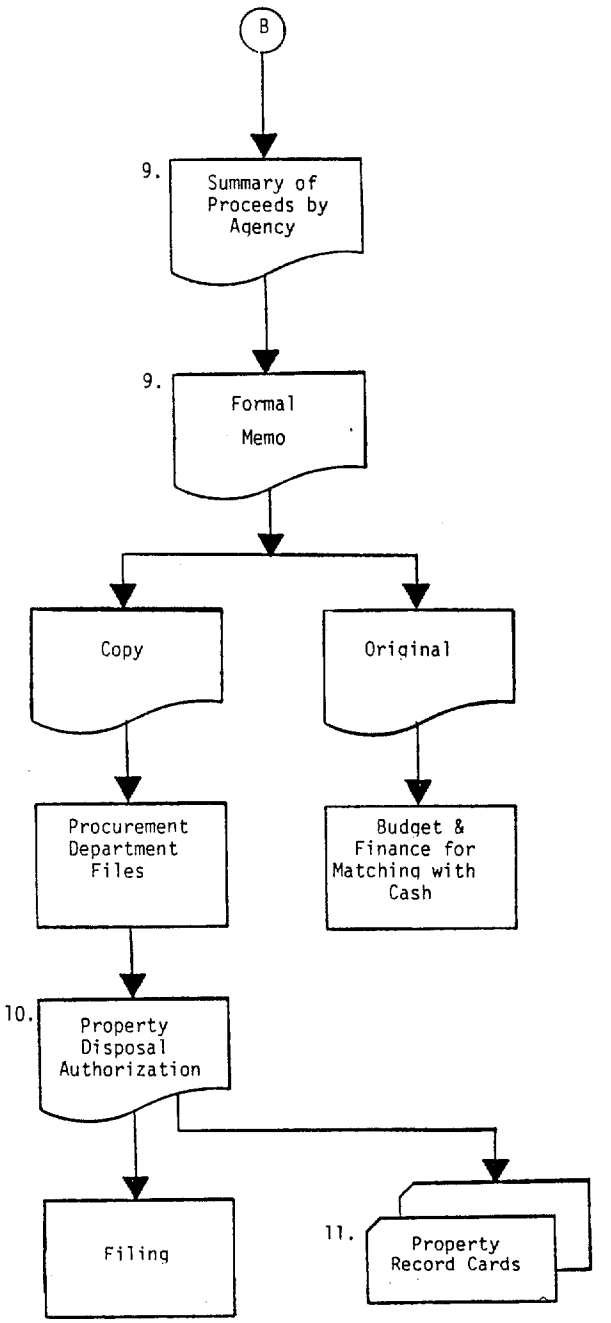


EXHIBIT B

What Is Internal Control

The U.S. General Accounting Office, in prescribing standards for Internal Controls in the Federal Government, states that "Good internal controls are essential to achieving the proper conduct of Government business with full accountability for the resources made available. They also facilitate the achievement of management objectives by serving as checks and balances against undesired actions. In preventing negative consequences from occuring, internal controls help achieve the positive aims of program managers."

For internal controls to be effective, government officials should ensure that they have established an environment that creates the appropriate control awareness, attitude and discipline and that each control system: fits the organization and its operating philosophy, focuses on areas of inherent risk, and achieves a thoughtful balance between control costs and benefits. What constitutes an effective system of internal control is a difficult question. Government officials should ensure that they have established an environment that creates the appropriate control awareness, attitude and discipline and that each control system: (1) fits the organization and its operating philosophy, (2) focuses on areas of inherent risk and (3) achieves a thoughtful balance between control costs and benefits. The following concept of internal control as defined by the U.S. General Accounting Office (GAO) is essential in understanding and applying an effective system of internal control.

"The plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports."

Therefore, in accordance with this concept the ultimate responsibility for good internal controls rests with management. In this sense internal controls are really management controls.

Internal controls or management controls should not be looked upon as separate systems within an agency. Rather, they should be viewed as an integral part of each system that management uses to manage its operations. Good management controls are essential to achieving the proper conduct of government business with full accountability for the resources made available to management.

The achievement of management's objectives and goals is also facilitated by good internal controls by serving as checks and balances against undesired actions.

The role of people-

There are many factors beyond good organization, management systems and procedures which can offset the quality of the control environment within a governmental organization. Such factors include:

- The attitude of senior officials with respect to the importance attached to good internal controls.
- Supervisory level acceptance of responsibility for proper execution of controls within their activity.
- The knowledge of all employees, supervisory and others, that an effective control evaluation and review procedure has been constituted within the organization.

Reasonable assurance that the objective of internal controls are achieved also depends on the competence and integrity of personnel, the independence of their assigned functions, and their understanding of prescribed procedures. The overall effectiveness of controls depends on having an adequate number of competent employees to administer controls at all levels.

Although these factors are individually important, their combined contribution is to provide an environment conducive to achieving good internal control.

A control procedure which requires the exercise of judgement beyond the ability or experience of the individual expected to execute the control cannot be effective. Managers should be satisfied that, at all levels of their operations they have:

- Screened the background of all employees who will perform control functions.
- Determined the qualifications needed for each position.
- Assigned or promoted appropriately qualified individuals.
- Provided a clear statement of responsibilities and the reasons for them.
- Provided adequate training and supervision.
- Measured the quality of individual performance.

All too frequently documented control systems are found to contain major weaknesses simply because of a lack of recognition that a well-maintained control environment requires senior management, supervisory and employee support, attention and compliance. Although we have discussed the need for evaluating the effectiveness of internal controls, such evaluations will prove to be of

little continuing value unless appropriate recognition is given to these human factors. We believe these human factors are particularly pertinent in this case as is evidenced by our findings and recommendations.

The extent of controls-

If controls were free or funds were unlimited, controls might be installed to cure every known weakness. But funds are limited and controls are not free. The time that can be devoted to evaluating internal controls is limited. Thus, it is important to focus on the greatest exposures first and cure them. Then, as time is available to look at the lesser exposures, they should be pursued. A technique that can be used to facilitate this decision-making process is known as the "worst case" method.

The first step is to conjuncture the "worst case" - the greatest amount of loss and the greatest frequency of occurrence reasonably attributable to the weakness. If the "worst case" exposure is not large, the weakness should simply be documented and reserved for consideration at a later time.

Frequently, there are a number of control techniques available, each with different costs and offering different degrees of effectiveness. One class of controls is designed to prevent errors from occurring in the first place. Another class of controls is intended to discover and correct an error if it does occur. For example, using a calculator instead of mental arithmetic is designed to prevent errors. Having a second clerk check the work of the first is designed to detect and correct any errors that might have been made.

When forced to choose among controls when only a limited number can be chosen, usually those controls that are designed to prevent or detect the largest amount of errors should be chosen.

In summary, the discussion contained in the above paragraphs relates to the standard of reasonable assurance. Reasonable assurance is one of the general internal control standards prescribed by GAO and required to be implemented by all federal agencies.

Federal Managers Financial Integrity Act (FMFIA)-

The provisions of the FMFIA are designed to re-emphasize that government managers are accountable for the efficient and effective operations of programs under their control. As such, Federal Government officials have to (1) establish and maintain effective internal controls, and (2) assure the President and Congress on the adequacy of those controls each year.

To ensure that this goal is met, the FMFIA amended the Accounting and Auditing Act of 1950 to require:

1. Each Federal agency must maintain an effective system of internal accounting and administrative controls as an integral part of its management practices.

2. The systems of each agency shall be evaluated on an ongoing basis and weaknesses when detected, must be promptly corrected.

3. All levels of management in the Federal agencies must involve themselves in assessing and strengthening the systems of internal accounting and administrative controls to minimize fraud, errors, abuse and waste of government funds.

The FMFIA requires the Comptroller General to establish standards for internal accounting and administrative controls which shall provide <u>reasonable assurances</u> that:

- Obligations and costs comply with applicable law.

- All assets are safeguarded against waste, loss, unauthorized use, and misappropriation.

- Revenues and expenditures applicable to agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained.

In addition, the Act directs the heads of executive agencies to:

- Make an annual evaluation of their internal controls using guidelines established by the Office of Management and Budget.

- Provide annual reports to the President and Congress that indicates whether agency systems of internal control comply with the objectives of internal controls set forth in the Act and with the standards prescribed by the Comptroller General.

- Where systems do not comply, agency reports must identify the weaknesses involved and describe the plans for corrective action.

Exhibit C contains the Comptroller General's internal control standards to be followed by Executive agencies in establishing and maintaining systems of internal control as required by the FMFIA.

INTERNAL CONTROL STANDARDS

The internal control standards define the minimum level of quality acceptable for internal control systems in operation and constitute the criteria against which systems are to be evaluated. These internal control standards apply to all operations and administrative functions but are not intended to limit or interfere with duly granted authority related to development of legislation, rulemaking, or other discretionary policymaking in an agency.

General Standards

1. Reasonable Assurance. Internal control systems are to provide reasonable assurance that the objectives of the systems will be accomplished.

2. Supportive Attitude. Managers and employees are to maintain and demonstrate a positive and supportive attitude toward internal controls at all times.

3. Competent Personnel. Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to accomplish their assigned duties, as well as understand the importance of developing and implementing good internal controls.

4. Control Objectives. Internal control objectives are to be identified or developed for each agency activity and are to be logical, applicable, and reasonably complete.

5. Control Techniques. Internal control techniques are to be effective and efficient in accomplishing their internal control objectives.

Specific Standards

1. Documentation. Internal control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination.

2. Recording of Transactions and Events. Transactions and other significant events are to be promptly recorded and properly classified.

3. Execution of Transactions and Events. Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority.

4. Separation of Duties. Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions should be separated among individuals.

5. Supervision. Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved.

6. Access to and Accountability for Resources. Access to resources and records is to be limited to authorized individuals, and accountability for the custody and use of resources is to be assigned and maintained. Periodic comparison shall be made of the resources with the recorded accountability to determine whether the two agree. The frequency of the comparison shall be a function of the vulnerability of the asset.

Audit Resolution Standard

Prompt Resolution of Audit Findings. Managers are to (1) promptly evaluate findings and recommendations reported by auditors, (2) determine proper actions in response to audit findings and recommendations, and (3) complete, within established time frames, all actions that correct or otherwise resolve the matters brought to management's attention.

Exhibit D

Property designated for disposal
located on roof of warehouse.
(recommendation 3a)

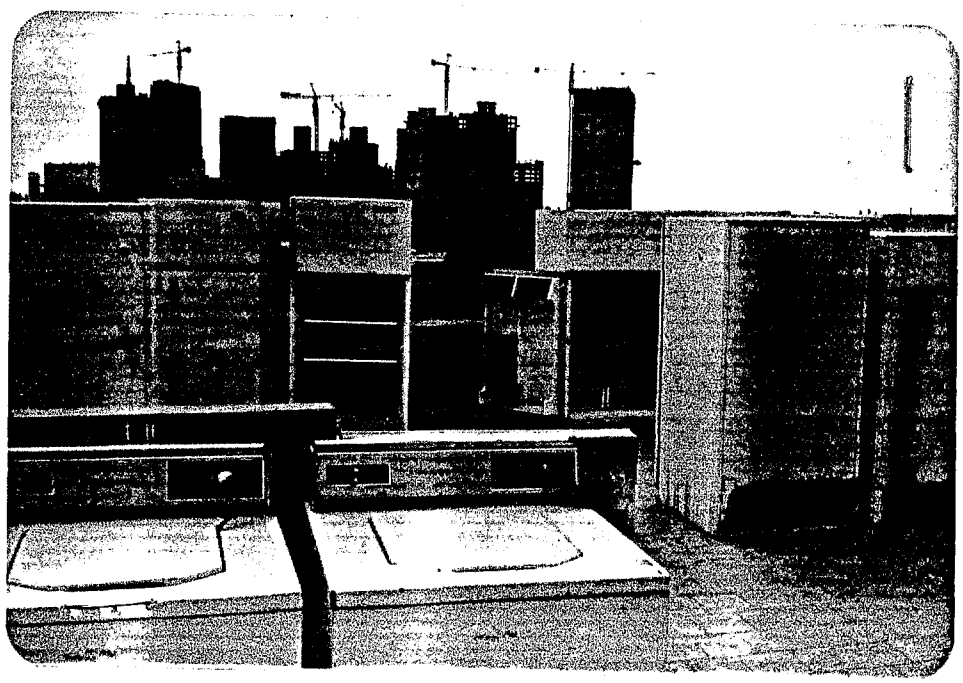
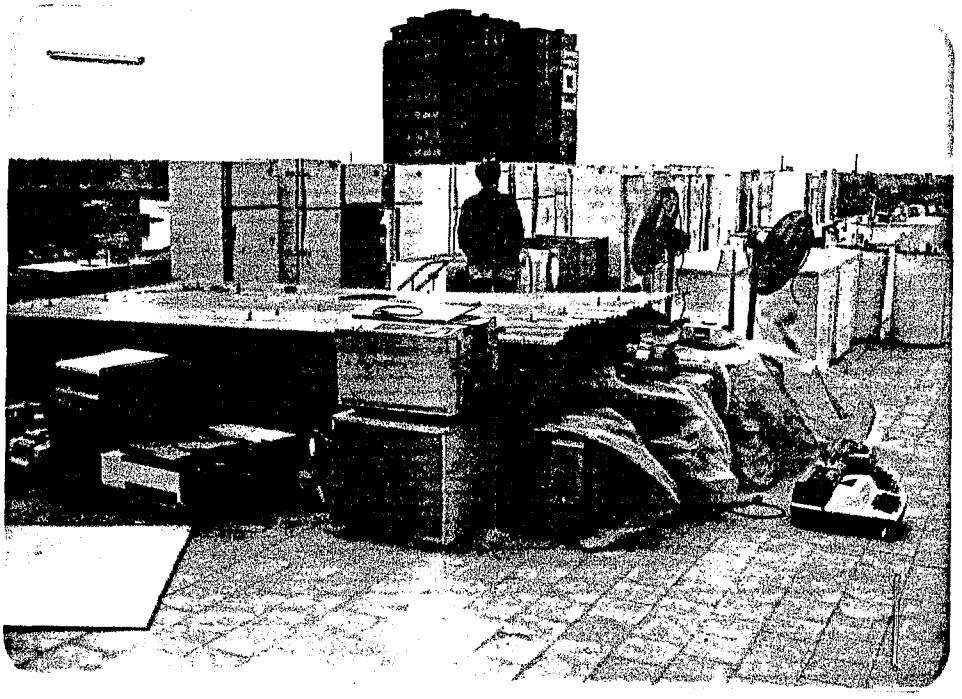
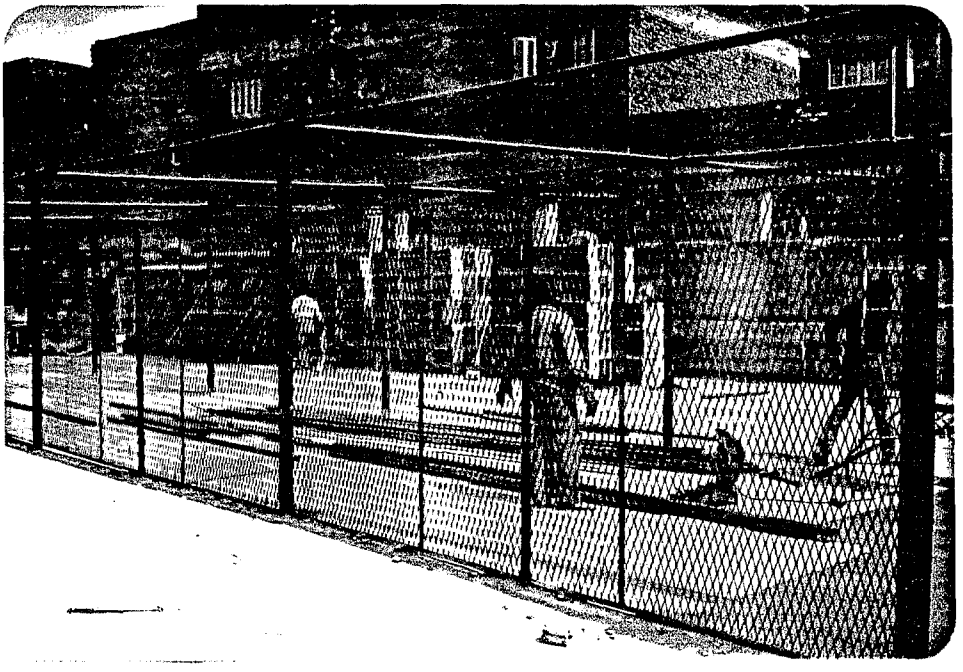


Exhibit D

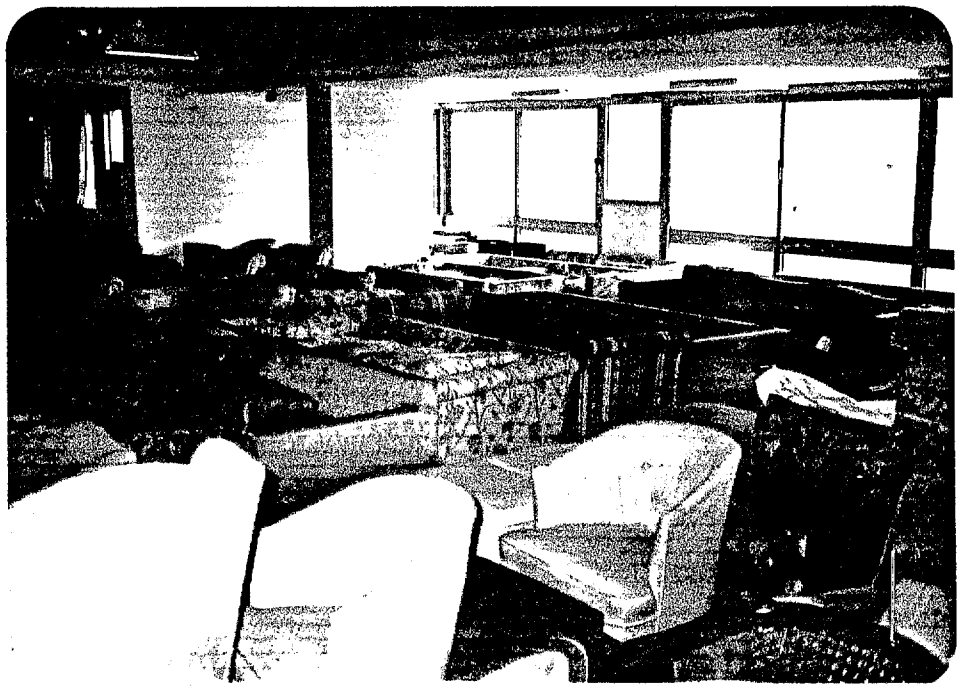


Property designated for disposal
located on roof warehouse.
(recommendation 3a)



Construction of storage area for
assets pending disposition.

Exhibit D



Furniture storage at warehouse.

Wall surrounding complex that should have barbed will along the top (recommendation 4d).

APPENDIX 1

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