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IN REPLY REFER TO:
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FEB 27 1979

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Mr. Thomas A. Smith, Field Director
Veterans Canteen Service Field Office
Veterans Administration
Room 1702, 211 Main Street
San Francisco, California 94105

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AGC00142

Dear Mr. Smith:

We have completed our audit of the San Francisco Field Office's financial statements for fiscal year 1978. The following are the more important observations made during our review which relate to the financial statements and your control over operations. All of these items have been discussed with you and your staff.

Understatement of accumulated amortization

Amortization expense for an air conditioning system was reported as depreciation rather than correctly charged as amortization. This incorrect charge in the amount of $2,372.82 would materially increase the reported September 30, 1978, accumulated amortization balance of $2,227.06 to $4,599.88, a 107 percent variance. The effect, however, is minor on the accumulated depreciation balance when overstated by the same amount. The incorrect change appears to result from improper posting and does not affect the income statement because depreciation and amortization expenses are reported as one amount.

Improvements needed for estimating receivables

Better procedures are needed for estimating receivables at year-end from companies operating vending machines at the various canteens. The San Francisco Field Office's Supplementary Operating Procedure Letter 6-77 states that sales and commissions from these vending machines will be reported between the 25th and the last day of each month. If canteen officials have not received this information from the vendor by the end of the month, they should call the vendor or estimate both the sales and commission due to VCS. Receivables from vending companies represented about 14 percent of VCS' total September 30, 1978, receivable balance.

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We noted that amounts for this type of receivable were often overstated estimates made by various canteen officials. Seven of 18 vendor company receivables we reviewed were overstated by about $3,000 or 30 percent. This appears to result from poor estimating methods. For example, the estimate from one canteen was based on commissions from vending sales of $6,560 for September 1978. But, actual sales during this period were only about $3,400 or one-half of the basis used for the estimate. Also, the estimated sales commission was recorded as a receivable of $1,640, but the actual amount should have been a credit to the vendor for $226 because of a previous overpayment by the vendor. These estimates, in our opinion, appear to vary among the various canteen officers because of insufficient procedures.

We suggested that better and more consistent estimates may occur if your field office personnel did this estimating instead of each canteen officer. During our discussion, you indicated that the responsibility for making these estimates should remain with the canteen officers, but better control is perhaps needed and you would take corrective action.

Canteen's overhead costs improperly distributed

Overhead depreciation expenses at the canteens are not distributed in accordance with VCS procedures. VCS operating procedures 731.02 dated April 12, 1977, states that depreciation charges on canteen overhead equipment will be distributed equally between the retail and manual food operation departments. We found, however, that these changes are actually being distributed on a ratio of 75 percent to retail and 25 percent to the manual food operations. Our analysis shows that this improper charge allocation resulted in overstating retail expense $2,258 and understating the food expense by the same amount.

We recommended that the San Francisco Field Office follow established procedures for distributing canteen overhead charges. During our discussion, you assured us that you have corrected your procedures.

Errors in computing depreciation expense

Depreciation expense is in error because some equipment purchases are not recorded in the proper fiscal year of purchase. VCS determines its depreciation expense by applying a different percentage factor to the total cost of equipment based on a 12-year life and year of purchase. Therefore, because a different percent factor is applied to each year equipment is purchased, equipment recorded in the wrong fiscal year will affect the depreciation expense.

Our findings of equipment items not allocated to the proper fiscal year due to improper adjustments made for the FY 1976 transition quarter was brought to your staff's attention. They subsequently revised the records and recomputed the depreciation expense for FY 1978. The effect of this correction indicated that the previous depreciation expense was overstated by about $5,300. We noted, however, that many equipment items are still recorded in the wrong fiscal year. For example, our analysis of 22 such items showed that VCS officials recorded the equipment in the calendar year received or the fiscal year an item was paid for rather than the fiscal year it was received.

In our opinion, the effect of these errors are minor. You may, however, wish to again review the equipment balances to accurately determine the deprecitation expense.

<u>Canteens improperly charged for occupancy by VA hospital</u>

We noted that the Veterans Administration Hospital at Palo Alto overcharged VCS for space and utilities used by the Menlo Park canteen and undercharged the Palo Alto canteen. The Engineering Service which supports both the Palo Alto and Menlo Park canteens established monthly rates charged to these canteens based on such items as the amount of space and estimated electricity used by each canteen.

We estimated that about $5,701 was overcharged during FY 1978 and $1,425 during the last 3 months of FY 1977, to Menlo Park as a result of inadvertently charging this canteen the same amounts as those being charged to the Palo Alto canteen for various utility services. The Palo Alto canteen was undercharged on refuse and gas by about $2,073 during the same 15-month period. Documentation supporting the amounts that should have been charged to Menlo Park showed that this canteen's space and utility expenses were substantially less. For example, the following table illustrates the principal items overcharged.

	Monthly charges	
	Amounts charged	Correct charge based on documentation
Steam	$433.18	$153.34
Electricity	189.61	111.05
Gas	24.72	0
Water	72.96	47.56
Sewage	55.36	6.40

We reported this matter to the VA Palo Alto Hospital Engineering Service. As a result, the Engineering Service recalculated the utility charges and prepared vouchers to refund the net 15-month over- and under-charges made to the Palo Alto and Menlo Park canteens as shown above. During our discussion, you assured us that your staff would follow-up on this matter to insure that VCS received the proper refund.

Observations at selected canteens

Our work at the San Francisco, Palo Alto, and Livermore canteens disclosed internal control weaknesses that we brought to your attention. The weaknesses discussed below should be reviewed by VCS supervisors and internal auditors during their visits to these and other canteens.

San Francisco Canteen

Our interviews with several canteen employees indicated that their actual time spent on tasks related to the retail and food departments were not consistent with the canteen's wage and salary charge distribution. For example, the acting canteen officer estimated his time spent in various departments as 65 percent retail, 25 percent food and 10 percent other. In contrast, his salary was distributed as 25 percent retail, 60 percent food and 15 percent charged to other departments. This improper charge distribution distorts the canteen's income and expense statement shown for various departments and the results of this canteen operations may not be comparable to other canteens.

Palo Alto and Livermore Canteens

At these canteens, we noted many items such as chairs, storage cabinets, vanities, hat racks, etc., that had no VCS identification number nor were they listed on these canteen's equipment inventory register. The ownership of these items, we believe, should be established and they should be recorded if VCS property.

At the Palo Alto Canteen, we noted instances where many cash register shortages and overages were occuring. Also, several employees may operate the same cash register without recording totals and cash count or using different cash drawers.

During our discussion you informed us that (1) inaccuracies in the distribution of salary charges such as the ones we noted in the San Francisco Canteen are common, but you constantly try to keep these charges as accurate as possible, (2) improvements are needed to insure all asset items are recorded and you will take the necessary corrective action, and (3) improvements in employee accountability over cash registers should occur when VCS installs its new electronic registers.

* * * *

The agenda we provided you prior to our exit conference contains most of the items addressed in this letter as well as other items that require discussion at the VCS Central Office level. We do not plan any further review effort at the San Francisco Field Office at this time. We will appreciate receiving your written comments on each of the items discussed in this letter.

Thank you for the cooperation and assistance received during our review.

Sincerely,

William N. Conrardy

William N. Conrardy
Regional Manager