

BY THE COMPTROLLER GENERAL

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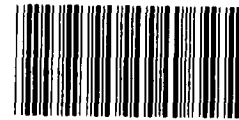
Report To The Congress

OF THE UNITED STATES

Weaknesses In Accounting For Government-Furnished Materials At Defense Contractors' Plants Lead To Excesses

The Defense policy to rely almost solely on contractors for accounting controls over the estimated billions of dollars in materials furnished to them is not effective. GAO's review of four production contractors showed that lack of proper accounting controls led to Defense providing, or initiating shipments of, \$1.3 million in material that was over contract allowances. This same problem was noted in prior GAO and Defense reports on overhaul and repair contracts.

The Secretary of Defense should require the military services to establish systems which, together with contractors' records, will effectively account for and control Government-furnished material.



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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the lack of Defense accounting controls over the estimated billions of dollars in Government material furnished to contractors. Defense should develop accounting systems to help manage these assets and to preclude issuing Government-furnished material in excess of contract allowances. This job was undertaken as part of our effort to determine whether executive departments and agencies have adequate accounting control over funds and assets. We requested written formal comments from Defense, but the comments were not received in time to be included in the report.

We are sending copies of this report to the Director of the Office of Management and Budget and to the Secretaries of Defense, the Army, the Navy, and the Air Force.


Comptroller General
of the United States

- Thirteen communication shelters worth \$76,000 that were needed by the Army but were excess to contract allowance and contractor's needs sat at the Army contractor's plant for 4 years without the Army knowing it. (See p. 8.)
- A \$65,000 computer supplied to a Navy contractor above contract allowances sat idle at the contractor's plant for almost 3 years. The Navy is buying additional computers. (See p. 8.)
- Eight cable driven modems (used in telecommunications) valued at \$120,000 were furnished to an Air Force contractor even though they were not authorized by the contract. They were not needed or used. (See p. 8.)

In prior reports on weaknesses in accounting for materials furnished to overhaul, maintenance, and repair contractors, GAO and Defense audit organizations noted that (1) contractors were oversupplied with materials, (2) contractors were given access to Defense supply systems without Defense accounting control over materials obtained, and (3) contractors' property control records were unreliable. The weaknesses also exist in production contracts.

GAO undertook this review because of (1) congressional interest in prior audits of material provided to overhaul, maintenance, and repair contractors, (2) the estimated value of the Government's investment, and (3) GAO's responsibility for approval of executive agency accounting systems. GAO principles and standards for executive agency accounting systems require that Government property be under accounting control from the time it is acquired until it is consumed or disposed of.

To ensure adequate accounting of Government-furnished materials, the Secretary of Defense should halt Defense's policy of almost total reliance on contractors' property control records and instead establish systems which, together with contractors' records, will

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

WEAKNESSES IN ACCOUNTING FOR
GOVERNMENT-FURNISHED MATERIALS
AT DEFENSE CONTRACTORS' PLANTS
LEAD TO EXCESSES

D I G E S T

The military services, for the most part, do not account for the estimated billions of dollars in Government-furnished material provided to Defense production contractors. Even when the services attempt to account for material, the data is incomplete and inaccurate. This has led to furnishing material to contractors in excess of contract allowances.

It is Defense policy to rely almost solely on the contractors' property records to account for and control Government-furnished material. The policy is not effective. GAO's review of four production contractors showed that the lack of accounting controls led to Defense providing, or initiating shipments of, \$1.3 million in material above contract allowances. This problem was noted in prior GAO and Defense reports on overhaul and repair contracts.

Generally, providing excess material to the four contractors GAO reviewed was caused by (1) clerical/arithmetical errors (2) lack of coordination among procuring activity personnel, and (3) failure to modify contracts to show changes in Government-furnished material authorizations. In each of the following examples, an effective accounting system would have helped (1) to disclose these errors and (2) identify or prevent excess material from being shipped to contractors.

--Fourteen semitrailers worth \$251,700 over contract allowance were being supplied to an Army contractor. The Army cancelled the shipment when GAO brought the overage to its attention. Cost to ship the semitrailers would have been \$9,000. (See p. 7.)

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provide accounting control over Defense material from receipt to consumption or disposal.

RECOMMENDATIONS

GAO recommends that the Secretary of Defense instruct the military services to:

- Develop accounting systems that establish a means of determining the quantity and value of Government-furnished material (1) contractually allowed to contractors, (2) actually provided to contractors, (3) reported as received by contractors, (4) reported as used by contractors, and (5) reported as on hand by contractors. The systems should include adequate accounting for Defense materials that are obtained by production contractors directly from Defense supply systems.
- Identify production contracts which have significant amounts of Government-furnished material and determine whether such material is authorized and required.

GAO also made other recommendations to strengthen Defense's control over Government-furnished material. (See p. 18.).

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ABBREVIATIONS

GAO	General Accounting Office
GFM	Government-furnished material

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important role in the process. Such a system would allow the contractor to continue to use the Defense supply system, but pay cash for any material requisitioned. The Committee was particularly concerned with overhaul and repair contracts. Defense officials, however, felt that such a system of selling materials, which are not excess to the Defense supply system, to contractors for use on Government contracts is not legal.

To provide for the authority of Defense procurement activities to sell material to contractors for use on Government contracts, the Congress in the 1980 Department of Defense Appropriation Act, Section 767, stipulated:

"Supplies available in inventories financed by working capital funds established pursuant to section 2208 of title 10, United States Code, may hereafter be sold to contractors for use in performing contracts with the Department of Defense."

However, materials financed by monies other than working capital funds were not mentioned. Materials financed by monies other than working capital funds will continue to be provided to contractors as GFM.

CHAPTER 1

INTRODUCTION

The Department of Defense has estimated that it gives billions of dollars of Government material to contractors for use on Defense production, overhaul, and repair contracts. Government-furnished material (GFM) includes parts, components, assemblies, raw and processed materials, and supplies that are attached to or incorporated into Government end items by contractors. The material is either owned or acquired by the Defense agencies and is issued to contractors as part of a contractual agreement for production of new items or for overhaul or modification of existing items.

Contractors are required to manage GFM in accord with procedures in the Defense Acquisition Regulations. Under these procedures, contractors must establish and maintain a system to control, protect, and preserve Government property. These systems are subject to review and approval by the Government's property administrators. The policy is to rely almost entirely on contractors' property control records and designate the contractors' books as the official records. Contractors are supposed to keep adequate accounts for all GFM provided under a contract. The official records (the contractors' books) must be kept current so that at any stage of work, the status of GFM may be ascertained. Generally, Defense agencies do not maintain independent accounting control over production GFM after it is provided to contractors.

SYSTEM WEAKNESSES NOTED IN HOUSE APPROPRIATION COMMITTEE HEARINGS

Weaknesses in the system for handling and accounting for GFM were pointed out in the fiscal 1979 and 1980 House of Representatives hearings on Defense appropriations. Committee members were particularly concerned with Defense procedures which allow contractors to requisition spare parts and other products directly from the Defense supply system. In this method of furnishing GFM, the contractor is no different to the supply system than a military unit. The contractor simply places the item's catalog number and a reimbursement code on a punch card and forwards it to the appropriate inventory manager. The item is then automatically shipped to the contractor. Several Defense audit activities issued internal audit reports citing a number of abuses of this system.

In view of the weaknesses noted in the present system of supplying material to contractors, the Appropriations Committee felt that many of the problems cited could be avoided simply by allowing the "laws" of economics to play a more

property accounting. The more important laws relating specifically to property accounting include:

- National Security Act of 1947, as amended.
- Federal Property and Administrative Services Act of 1949.
- Public Law 863, 84th Congress, August 1, 1956.

Generally these laws require that agencies maintain adequate inventory control and accounting systems on both a quantitative and monetary basis.

Problems in approving Defense accounting systems

Many Defense accounting systems have not been approved by the Comptroller General because they do not meet legislative requirements and they are not based on sound accounting theory.

The Budget and Accounting Procedures Act of 1950 holds the head of each agency responsible for establishing and maintaining adequate systems of accounting and internal control. This act requires that the Comptroller General approve executive agency accounting systems when they conform with prescribed principles and standards. The act also provides that the Comptroller General can report to the Congress any agency failures to adequately account for property.

Forty-eight of the 118 Defense accounting systems remained unapproved by the Comptroller General at the end of fiscal 1979. Before 1972, only four Defense accounting systems were approved. Between 1972 and 1977, Defense made substantial progress in obtaining approval of its accounting systems. However, during fiscal 1978 and 1979 only 12 accounting systems qualified for approval. One of the major deficiencies in the unapproved accounting systems is the lack of monetary control of Government property, including property in the hands of private contractors.

All Government property should be under general ledger control from the time it is acquired until it is consumed or disposed of. The general ledgers should be used to record the dollar value of all property and should serve as an independent control total over the subsidiary detailed property records required to be kept by property officers. Although Defense recognizes the need for monetary property accounting in its own principles and standards, it only recently has begun correcting the situation.

CHAPTER 2

MILITARY PROPERTY ACCOUNTING SYSTEMS FOR

MATERIAL PROVIDED TO PRODUCTION CONTRACTORS ARE INADEQUATE

The military services, generally, do not account for Government-furnished material provided to Defense production contractors. When some attempt is made to account for material, the data is incomplete and inaccurate. We found that this lack of accounting resulted in material over contract allowances being furnished to contractors. This causes material to be unavailable for existing Defense needs and results in unnecessary procurement and transportation costs.

It is Defense policy to rely almost entirely on contractors' property control records. Records maintained by two of the four contractors we reviewed were inadequate and as a result, for material going to those two contractors, there was little or no accounting control over Government material at any level. The problem is compounded by some contractors having direct access to Defense supply systems without Defense accounting for material authorized or actually obtained.

These same weaknesses were noted in Defense and our previous reports on material provided to overhaul, maintenance, and repair contractors.

REQUIRED ACCOUNTING DATA ON PRODUCTION GFM IS NOT MAINTAINED

Although the Congress has emphasized the need for adequate property accounting by Federal agencies and has made the Comptroller General responsible for approving adequate Federal agency accounting systems, Defense does not have accurate accounting data showing the quantity and value of production GFM provided to contractors. The Army has requirements for financial accounting control over production GFM but maintains inaccurate and incomplete data. The situation in the Navy and Air Force is even worse because those services have no requirements for accounting control over production GFM and, therefore, do not maintain accounting data on it. Although Defense does not maintain accurate data on the value of production GFM, Defense officials estimate it at billions of dollars.

Legal requirements for property accounting systems

The Congress has long recognized the need for accurate

at two of these four activities included only values on relatively low valued consumption-type items which are financed by stock funds. The general ledgers did not include values of higher valued investment-type items which are financed by appropriated funds. General and subsidiary ledgers at the Army's fifth procuring activity also included only values on consumption-type items. However, even these values were so inaccurate that the procuring activity declined to provide us with a dollar value of its outstanding GFM.

The one Army procuring activity included in our review had general and subsidiary ledgers which included both investment- and consumption-type items but the ledgers were inaccurate. This activity's subsidiary ledgers showed that 106 contractors had \$24.6 million in production GFM as of December 31, 1978--\$3.6 million of the \$24.6 million was shown as on hand at the two contractors included in our review. However, only \$650,000 in GFM was actually on hand at the two contractors' plants. The difference occurred primarily because the Army's computerized system is unable to reduce account balances when GFM is incorporated into end items by contractors.

Further, although the total values reported by the procuring activity in its general and subsidiary ledgers agreed, both were inaccurate. A comparison of the activity's shipping records and ledgers showed an absolute difference of \$1 million in the value of GFM provided to the two Army contractors included in our review. The difference occurred because (1) values of items shipped were not recorded in the ledgers, (2) values of items not shipped were recorded in the ledgers, and (3) values assigned to shipments differed between the shipping records and ledgers.

The Navy and Air Force do not
maintain accounting data on GFM

Although accounting control over GFM provided to Army production contractors is ineffective, the situation in the Navy and Air Force is worse because these services have no requirements for accounting control over GFM and, therefore, do not maintain accounting data on GFM provided to production contractors.

LACK OF ACCOUNTING CONTROL
LEADS TO EXCESSIVE MATERIAL
PROVIDED TO CONTRACTORS

Substantial amounts of GFM excessive to contract allowances were provided or were being provided to the four contractors included in our review. This occurred because

After we conferred with Defense officials about the need for property accounting systems in November 1978, they agreed that the military services will develop better general ledger control over property. In September 1979 the Office of the Secretary of Defense submitted a new uniform chart of financial accounts to the military services for comment. The Office developed the accounts to establish financial control over all resources from receipt to consumption or disposal. The accounts include provisions for financial control over GFM. However, Defense has not specifically required the military services to devise a financial accounting system or subsystem to control GFM. Defense officials believe that financial accounting systems developed from the chart of accounts will not be fully designed and implemented for several years. No system can be approved until it includes the required property accounting procedures.

On May 29, 1980, Defense officials advised us that a draft of a new Defense instruction covering control of Government-furnished material provided to contractors for maintenance contracts was being coordinated in the Department of Defense. The draft instruction requires control and accounting for GFM requisitioned by maintenance contractors. The draft also establishes for each military service a management control activity which is required to maintain a financial inventory account to reflect the amount of GFM issued and balances on hand for each contractor. Defense officials said they are considering extending the provision of the instruction to production contractors receiving GFM.

The Army maintains inaccurate accounting data on GFM

Although the Army requires financial accounting data to provide control over production GFM, Army procuring activities do not maintain accurate data to achieve such control.

The Army requires general and detailed subsidiary ledgers to provide financial control over production GFM provided to contractors. The ledgers are intended to show the outstanding value of production GFM in the hands of contractors. The ledger balances are to be increased when GFM is issued and decreased when GFM is (1) consumed, (2) incorporated in end items delivered to the Government, or (3) returned to the Government as excess.

Even though the Army requires general and detailed subsidiary ledgers, only two of the Army's five procuring activities maintain subsidiary ledgers. The general ledgers at four of the Army's five procuring activities showed a total of \$92 million in outstanding GFM. However, general ledgers

our review. This direct shipment was made because the procuring activity's contracting officer previously had ordered a transfer of 60 power invertors from the contractor included in our review to another contractor. Procuring activity personnel responsible for supplying GFM were aware of the contracting officer's transfer but not of the "direct shipment." The personnel responsible for supplying GFM were under the impression that 60 power invertors were still needed to replace those that were transferred by the contracting officer.

- Thirteen communication shelters valued at \$76,000, needed by the Army but excess to contractual allowance and contractor needs, sat at the second Army contractor plant included in our review for 4 years without Army inventory managers knowing it. The 13 shelters sat idle because of no coordination among procuring activity personnel. In 1975, the procuring activity's contracting officer told the contractor to retain 13 shelters that were excess to contractual needs until disposition instructions were issued by the procuring activity. However, the disposition instructions were not issued. The procuring activity's personnel responsible for supplying GFM thought that these shelters had been shipped to the Sacramento Army Depot by the contractor in 1975. The procuring activity's inventory manager for the shelters, who could have used the shelters to satisfy other needs, was unaware that there were any excess shelters.

- The Navy supplied a computer valued at \$65,000 to a contractor even though it was not authorized as GFM by the contract and was never used as GFM. The computer has sat idle at the contractor's plant for almost 3 years. A second unauthorized computer issued to this contractor also was not used by the contractor and was loaned to a west coast Marine Corps activity. At this time the Navy was purchasing additional computers. The computers were sent to the Navy contractor in excess of contract allowance because the contract was not modified to show changes in GFM authorization. Originally, one computer was to be loaned to the contractor for 30 days and returned. It was loaned, but was not returned. The Navy then decided to use two computers as GFM and supplied the contractor with a second computer. However, the contract was never modified to authorize either computer as GFM. The Navy subsequently decided that the computers would not be needed as GFM. One was placed on loan while the other sat idle at the contractor's plant.

Defense lacks adequate accounting systems to control GFM. By comparing GFM contract provisions to GFM actually provided to contractors, we determined that the four contractors were provided or were being provided \$1.3 million in GFM above the \$8.9 million that they were authorized. Generally, the excesses were caused by (1) clerical or arithmetical errors, (2) a lack of coordination between procuring activity personnel, or (3) failure to make contract modifications to show changes in GFM authorizations.

The undesirable ramification of supplying excesses is that the Government incurs unnecessary expense due to unneeded procurement and transportation costs. Further, in some instances, the material could be used to satisfy existing needs. The excesses found at the four contractors could be indicative of a much larger problem if one considers the total number of contractors receiving GFM.

Various Defense audit organizations have reported that contractors frequently are provided excess material in overhaul, maintenance, and repair contracts.

Unavailability of material and unnecessary costs incurred

In no event should the quantity of Government material on hand at a contractor's plant, plus material on order, exceed contractual requirements. If contractors are oversupplied with material it causes needed material to be unavailable and results in unnecessary costs. We believe the following examples, found at the four contractors we reviewed, show that adequate accounting systems are necessary to help ensure control over GFM.

--The Army was supplying a contractor with 14 semitrailers valued at \$251,700 and 60 power invertors valued at \$82,600, both items over contract allowance and over what the contractor could possibly use under the contract. Cost to ship the semitrailers would have been \$9,000. The Army canceled the shipments when we raised the matter. Due to a shortage of procurement funds, the Army expects a shortage of semitrailers for the next 2 years. The 14 semitrailers were being shipped because although the contract called for 160 semitrailers, requisitions were erroneously being processed for 174. The 60 power invertors would have been shipped due to a lack of coordination among procuring activity personnel. In this instance, the inventory manager for the power invertors had ordered a "direct shipment" (producing contractor to a using contractor) of 60 power invertors to the contractor included in

material caused unnecessary transportation expenses of \$75,500. Also, by the time the material was identified and returned, \$246,800 of this material was excess to Air Force needs.

--In 1978, the Defense Audit Service visited 10 contractors that had been awarded overhaul, maintenance, and repair contracts. The auditors estimated that three of the contractors had received about \$2 million more than necessary in GFM. The oversupplying of GFM resulted in both unnecessary transportation costs, as material had to be shipped back to supply points, and unnecessary disposal costs, as residual material had to be processed through plant disposal and contractors had to be reimbursed for disposal costs.

LACK OF ACCOUNTING CONTROLS
WHEN CONTRACTOR HAS DIRECT
ACCESS TO DEFENSE SUPPLY SYSTEMS

The Air Force procuring activity we reviewed does not have any accounting control over GFM that production contractors requisition directly from Defense supply systems. The Army and Navy contractors we reviewed were not given direct access to Defense supply systems. Although the Air Force has no overall policy on allowing production contractors direct access to Defense supply systems, the Air Force procuring activity included in our review has authorized its production contractors to requisition spare or repair parts directly from Defense supply systems. Due to the lack of accounting control over this GFM, unnecessary procurement and transportation costs can be incurred because the Government has no record of the amount of GFM at contractors' plants. Consequently, materials not contractually authorized and/or excess to the contractors' needs are warehoused by the contractor and sit unused until the contract ends. Prior audits of overhaul, maintenance, and repair contracts showed similar and more serious weaknesses when contractors were given direct access to Defense supply systems.

Lack of records on
materials requisitioned

The Air Force procuring activity had no summary accounting records of what the contractor was authorized to requisition or what he had requisitioned and obtained directly from the Defense supply system. A procuring activity official described the process as "like an open checkbook" for the contractor because the procuring activity does not verify contractor authority for requisitioning specific materials even though the procuring activity pays for the material.

--The Air Force delivered eight low-speed, cable drive modems (essential elements in telecommunications) valued at \$120,000 to a contractor even though the contract did not authorize them. According to the contractor, the eight modems were not needed. The contractor did not know why the Air Force sent them. They are now being shipped to an Army Test site. Due to numerous turnovers in the Air Force's personnel assigned to the contract, we were unable to determine why the Air Force shipped the eight cable drive modems to the contractor.

We believe the above examples are indicative of the need for accurate and reliable financial and quantitative property accounting systems that show the GFM that contractors (1) are allowed, (2) have been furnished, (3) have used, and (4) have on hand.

Defense audits disclosed
contractors oversupplied with GFM

Reviews by various Defense audit organizations of overhaul, maintenance, and repair contracts identified several instances where contractors were provided more GFM than necessary. The reviews showed that furnishing the contractor with excess GFM results not only in unneeded procurement and transportation costs, but in some instances, by the time the material is identified as excess, it is obsolete and can only be sold for scrap.

--In 1977, the Army Audit Agency, in a review of Army aviation items, reported that about \$5.5 million of GFM at four contractor plants was excess to current requirements. Also, material for overhaul and modification contracts was stocked in excess of contractual 90-day operating levels. Further, some of this excess material was necessary for new contracts.

--In 1978, the Naval Audit Service in a review of naval aviation repair items, reported that about one-half of \$2 million of GFM at six contractor plants was excess to contractor requirements. These findings were particularly significant as some of the materials could have been used to satisfy other high priority system requirements.

--In 1978, the Air Force Audit Agency in a review of the depot-level contract maintenance program reported that of \$1.8 million of GFM supplied to selected contractors, \$1.3 million was returned to the Air Force as excess. The delivery and return of the unneeded

only authorized three. The extra meter, valued at \$7,000, was delivered to the contractor even though the contractor thought the requisition for the meter was cancelled. When we brought this to the contractor's attention, he agreed the meter was excess to his needs and said he is returning it to the Air Force-- but the extra meter was lost to the Defense supply system for 1 year.

Prior audits disclosed numerous weaknesses when contractors are given direct access to Defense supply system

Prior audits by us and Defense of overhaul, maintenance, and repair contracts disclosed serious weaknesses and apparent misuse of GFM when contractors are given direct access to Defense supply systems and there is not proper accounting for the material. Our review has shown that the same general lack of control over GFM requisitioned directly from Defense supply sources also exists on production contracts. The weaknesses reported in prior audits of overhaul, maintenance, and repair contracts included (1) a general lack of control over GFM after it was requisitioned by the contractor, (2) contractor possession of unauthorized material, and (3) unauthorized use of GFM by contractors.

In 1976, we reviewed the procedures and controls over GFM held by overhaul and repair contractors performing contract maintenance for Air Force Logistics Centers. Air Force overhaul and repair contractors were given about \$200 million of GFM every year. We found that Air Force contractors ordered Government materials directly from Defense supply systems and received direct shipments with little or no Air Force surveillance. No effective system was established to find out from Government sources, amounts of materials ordered and received by contractors or of contractors' use of GFM compared with expected use. Contractors' use of GFM was further complicated because some contractors worked on similar Government and commercial items at the same plants.

This work and another related assignment in 1976 demonstrated that the lack of controls over GFM could lead to large-scale theft. Our work prompted the Federal Bureau of Investigation to make investigations which resulted in conviction of several contractor personnel.

In 1976, the Auditor General's office of the Defense Supply Agency audited the acquisition, use, and disposition of GFM by overhaul and maintenance contractors under the cognizance of the Defense Supply Agency. The auditors reported

Materials not available
to Defense supply system

As a result of the lack of accounting records on materials requisitioned directly from the Defense supply system, the Government has no record of the amount of GFM at the contractors' plants. Consequently, unnecessary procurement and transportation costs can be incurred because materials that are excess to the contractors' needs are not available to satisfy the requirements of other Defense activities and/or contractors. The Air Force contractor we reviewed requisitioned Government equipment in addition to GFM spare parts and end items. Although all other facets of our review focused solely on GFM, we also included Government equipment in this facet of the review. We cannot be sure we identified all the GFM and equipment that the contractor obtained directly from the Defense supply system because the Air Force procuring activity had no centralized accounting records on what was requisitioned. However, the following are examples of weaknesses caused by a lack of accounting records on GFM and equipment requisitioned from the Defense supply system.

- At the time of our review, the contractor had had 381 requisitions for GFM spare parts filled from the Defense supply system. The potential exists for substantial additional requisitioning. For 58 of the 381 requisitions, the contractor was provided with materials other than those he requisitioned. He could not use this material. Also, in 6 of 60 requisitions worth a total of about \$1,300 on which we did detailed work, we found that the contractor received more material than requisitioned. Since the contractor could not use these extra materials, he stored them in his warehouse where they will remain until the contract ends. Thus, the material is unavailable to other users of the Defense supply system until the contract ends. In the interim, unnecessary procurements could be made and if the materials are returned to the Government, unnecessary transportation costs will be incurred.
- Although the Air Force procuring activity had no accounting records on what the contractor was authorized to requisition, we reviewed volumes of correspondence maintained by the Air Force and the contractor so we could determine the material that the contractor was authorized to requisition. We found that the contractor requisitioned 13 end item GFM batteries valued at \$700 that he was not authorized.
- The contractor received four noise figure meters (Government furnished equipment) even though the contract

The following are some of the situations found at an Army and Navy contractor that indicate that the Defense policy of reliance on contractor records is inappropriate.

- The Army contractor received a total of eight GFM line items. We computed what the contractor should have had on hand (GFM received less GFM used in completed end items delivered to the Government) using his records. GFM on hand did not agree with what should have been on hand for any of the eight line items. There were two excesses on hand worth \$107,900 and six shortages worth \$22,200. The contractor could not explain any of the differences.
- The Army contractor's perpetual inventory records contained \$36,900 in incorrect quantity balances due to arithmetical errors.
- The Army contractor did not post \$121,600 in GFM to inventory records while the Navy contractor did not post \$647,500.
- The Navy contractor did not include \$93,500 in on-hand GFM in its inventory records while it did include \$1,100 in GFM even though that GFM was not on hand.
- The Navy contractor, due to a lack of direction from the Navy procuring activity, was confused as to whether property supplied by the Government should be classified as GFM or Government-furnished equipment. The contractor has separate accounting procedures for Government-furnished equipment. As a result, one entire completed end item, developed under the research and development contract which led to the production contract included in our review, was not accounted for as GFM. The completed end item as a whole was accounted for as Government-furnished equipment. However, individual components valued at \$844,000 were taken from the completed item and used as GFM without being accounted for as GFM. (An Air Force contractor was also misclassifying GFM as Government-furnished equipment.)

Prior audits indicated
unreliability of contractor
property control records

Reviews by us and Defense audit organizations in prior years of both aircraft development and testing and overhaul and maintenance contracts, pointed out serious deficiencies

several instances where contractors that were given direct access to Defense supply systems overrequisitioned material or acquired material for which there was no contractual authority. The Defense Supply Agency auditors reviewed GFM requisitions from 66 contractors and reported that 26 of the contractors had submitted requisitions for GFM above contractual requirements. The auditors estimated that these contractors were overrequisitioning about \$9 million worth of material each year.

Also, the auditors reported that \$1.5 million of material was acquired without contractual authority. These materials were being used by the contractors for independent testing and were not identified as GFM. In one instance, a contractor who did not have a contract to repair Government-owned engines, requisitioned \$3,000 of reciprocating aircraft engine and electrical system parts. In addition to their recommendations to the Director of the Defense Supply Agency, the auditors requested that the property administrator ascertain that the contractor's property control system ensure that requisitions for material are contractually authorized as GFM. This particular situation was subsequently referred to the Federal Bureau of Investigation.

DEFENSE POLICY OF RELYING ON
CONTRACTOR PROPERTY RECORDS
NEEDS TO BE CHANGED

Defense policy for GFM is ineffective and should be changed. Defense policy is to rely on contractor property control records as the official contract records. The official records are to be kept so that at any stage of work, the status of Government property may be readily determined. However, we found several instances that indicate that contractor property control records cannot be relied on. Over the years, various audit organizations have reported serious problems in relying on contractor records.

Unreliable contractor records

At two of the four contractors we reviewed, contractor records could not be relied on to give a true picture of GFM received, issued, and still in the hands of the contractor. This deficiency in contractor records compounds the problem of controlling GFM because of the lack of Government accounting records for this material. Procurement activities do not record the amount of GFM at contractors' plants until the material comes back into the Defense supply system as part of a completed end item.

INSUFFICIENT DATA
FOR PROPERTY REVIEWS

Government property administrators responsible for surveillance of production GFM do not have sufficient data to know that accountability is being maintained over GFM provided to contractors. A basic deficiency in the surveillance program exercised by Government property administrators is the lack of quantitative and financial data (independent of contractor records) with which to test control over GFM in contractor property control systems.

Defense does not provide
property administrators with
data needed for surveillance

Defense procuring activities do not provide property administrators with needed accounting data on the quantity and value of GFM supplied to contractors.

Government property administrators are responsible for reviewing and approving contractor property control systems. After approval, property administrators periodically check to ensure that the approved system is functioning as designed. The Defense Contract Administration Service was the property administrator for the four contractors included in our review. In 1979, the Service had 257 property administrators and assistants who received total annual salaries of about \$4.9 million. These employees are responsible for surveillance over not only GFM but also over Government special tooling, special test equipment, plant equipment, and other items provided to contractors.

Since Defense policy is to rely on contractor property control records as official contract records, the property administrator's starting point in checking a system is the contractor's records. The property administrator has no independent source to verify the amount of GFM provided to the contractor. According to a Service official, the procuring activity's data on material shipped to contractors would be significant in property checks in that the property administrator could identify the quantity and value of GFM the contractor had received. This information, coupled with usage data, would enable the property administrator to ascertain how much GFM the contractor should have on hand. The property administrator could then compare this data with the contractor's property control records and resolve any differences.

The present system of property administrators relying on contractor property records for the amount of GFM provided,

in various contractors' property accounting records for GFM. How well GFM is managed by contractors is especially important because in most instances the Defense procurement activities have no accounting records of their own and rely completely on the contractors' records to know how much GFM has been received, attached to or incorporated into end items, disposed of, or is still on hand at the contractors' plants.

- In 1975, we reviewed the management of spare parts provided a contractor for use in the development and testing of the F-14 aircraft. More than \$100 million in GFM consisting of aircraft spare parts had been furnished the contractor. We found serious weaknesses in the management and control of the spare parts. The contractor's inventory records were unclear as to the quantities of parts for which the contractor was accountable. In a sample test, GAO found discrepancies of about \$21 million in the contractor's principal inventory control report.

- In 1976, the Auditor General's office of the Defense Supply Agency audited the acquisition, use, and disposition of GFM by overhaul and maintenance contractors under the cognizance of the Defense Supply Agency. The audit was performed at 66 contractors who had about \$102 million in GFM. The Defense Supply Agency auditors reported that (1) contractors' handling of GFM needed improvement, (2) guidance provided by Defense procurement regulations was weak, and (3) surveillance of contractors' property control systems by Government property administrators was inadequate. Some specific examples of the unreliability of contractors' property control records were: (1) about \$1.6 million in GFM in 216 shipments from 18 supply activities to 44 contractors had not been recorded on the contractors' records, (2) inventory adjustments of \$311,000 in GFM at two contractors' plants were not reported to Government property administrators but were recorded on the contractors' stock records as returns and/or issues, and (3) residual GFM valued at \$358,000 was not accounted for by 17 contractors.

- In 1977, the Army Audit Agency, reporting on its review at four contractors' plants said that contractors' accounting controls over GFM were not adequate to prevent losses, and inventory records used by contractors to account for GFM were inaccurate. In one instance, adjustments totaling \$1.6 million were needed to make contractor inventory records for 56 high dollar value items agree with physical inventory counts.

- Develop accounting systems that establish a means of determining the quantity and value of GFM (1) contractually allowed, (2) actually provided to contractors, (3) reported as received by contractors, (4) reported as used by contractors, and (5) reported as being on hand by contractors. The systems should include adequate accounting for Defense materials that are obtained by production contractors directly from Defense supply systems.
- Coordinate with us during the development of these systems to assure they will comply with the Comptroller General's principles and standards.
- Provide developed accounting system data to property administrators so that they have independent data that they can use to pinpoint differences between Government and contractor records. Where differences exist, reconciliations should be made.

In our draft report to Defense we had also recommended that after adequate accounting systems for GFM are implemented, it discontinue the policy of relying on contractor records as official control records. We dropped this recommendation because if Defense implements the accounting systems as recommended, contractor records should still be included in the new system as official control records.

is inadequate. This is especially important because the services do not maintain adequate accounting on production GFM provided to contractors and thus, the value of GFM supplied to production contractors is unknown. We reviewed reams of procuring activity correspondence and related contract data and interviewed procuring activity contract personnel to determine the amounts of GFM shipped to the contractors reviewed. At one procuring activity, this was especially difficult because there were numerous changes in the activity's personnel assigned to the contract. In this instance, the Service property administrator was unaware of the excess materials that were provided to the contractor--the property administrator was responsible for controlling Government property of which he was unaware.

Procuring activity accounting data consisting of detailed quantitative and financial data on GFM provided to contractors should go to property administrators. It should be obtained from adequate procuring activity accounting records which do not exist now.

On May 29, 1980, Defense officials told us that they are considering a requirement to provide data to property administrators for verification of receipt at contractor plants.

CONCLUSIONS

Defense does not maintain adequate accounting for GFM provided to production contractors. As a result, millions of dollars of GFM have been provided to contractors (1) in excess of their contract authorizations and (2) in excess of the amount required to fulfill the contract. Several of the weaknesses found in prior audits on control of GFM furnished to contractors for use in overhaul, maintenance, and repair contracts also exist in production contracts.

To insure that there is adequate accounting for GFM provided to production contractors, the Secretary of Defense should discontinue Defense's policy of almost total reliance on contractor property control records and establish systems which together with records maintained by the contractor provide accounting control over Defense material from receipt to consumption or disposal.

RECOMMENDATIONS

We recommend that the Secretary of Defense instruct the military services to:

- Identify those production contracts which have significant amounts of GFM and determine whether the GFM on hand is contractually authorized and required.

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