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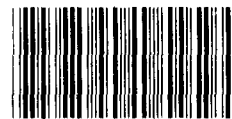
GAO

Report to Congressional Requesters

March 1988

# INTERNAL CONTROLS

## Air Force Can Improve Controls Over Contractor Access to DOD Supply System



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United States  
General Accounting Office  
Washington, D.C. 20548

National Security and  
International Affairs Division

B-229449

March 18, 1988

The Honorable Pete Wilson  
United States Senate

The Honorable John Glenn  
Chairman, Committee on  
Governmental Affairs  
United States Senate

As requested in Senator Wilson's letter of April 15, 1986, we reviewed the Air Force's controls over contractor access to the Department of Defense's supply system. This report is one in a series of reports related to the effectiveness of defense logistics.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to interested committees and other members of Congress; the Secretaries of Defense and the Air Force; and the Director, Office of Management and Budget. Copies will also be made available to other parties upon request.

Frank C. Conahan  
Assistant Comptroller General

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# Executive Summary

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## Purpose

Each year the Department of Defense (DOD) provides material worth billions of dollars through its supply system to a large number of contractors to produce items, maintain them, or provide various services for the Armed Forces. Because contractors have had widespread access to the DOD supply system in the past, Senator John Glenn, Chairman of the Senate Committee on Governmental Affairs, and Senator Pete Wilson requested that GAO examine DOD and service policies, procedures, and practices for providing and controlling government-furnished material (GFM). In this report, GAO focused on the U.S. Air Force and examined

- its compliance with requirements to justify and document decisions to provide material to contractors,
- the adequacy of management controls established to validate and approve contractor GFM requisitions, and
- the adequacy of government oversight over GFM in the possession of contractors.

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## Background

GFM includes parts, assemblies, and raw and processed materials used in research, development, production, maintenance, and repair of final products such as tanks, aircraft, and ships. GFM is also used in support of various services performed by contractors at military installations.

Under the Federal Acquisition Regulation, contractors are generally required to provide such material to fulfill their contracts; however, the government provides GFM when it is considered to be in its best interest. As of September 30, 1980, DOD estimated that U.S. Air Force contractors held about \$5 billion in GFM.

The Air Force allows contractors to obtain GFM by accessing the DOD supply system directly, ordering from base supply activities, or buying from commercial sources with Air Force funds. Since 1967, GAO, DOD, and Air Force audits have identified significant problems in the Air Force management and control of GFM. In July 1978, the House Committee on Appropriations recommended that DOD test a system that would allow contractors to use its supply system but pay for the GFM. However, contractors were reluctant to participate because of perceived financial risk. As an alternative, in 1981, DOD directed each service to establish one or more Management Control Activities (MCAs) to maintain central control over maintenance contractors' access to the DOD supply system by reviewing, validating, and approving requests for GFM. In March 1986, DOD expanded the MCA concept to include production, research and

development, and service contracts. The GAO review focused on maintenance and service contracts.

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## Results in Brief

The Air Force has not complied with DOD instructions that require a written evaluation or justification before providing GFM to contractors and in some instances has provided GFM even though the material was commercially available at lower cost.

The Air Force has not adequately implemented MCA controls at the wholesale level and has not yet established a target date for implementing such controls at the retail level. As a result, it cannot ensure that contractors requisition, receive, and use only the items and amounts of needed GFM provided for in their contracts. Also, after GFM has been issued to contractors, government property administrators have not performed required annual surveys or identified excess GFM inventories at contractors' facilities. And, Air Force accounting systems do not provide adequate identification of or control over the total amount of GFM provided to contractors. These control weaknesses offer the potential for fraud, waste, and abuse of GFM.

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## GAO's Analysis

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### GFM Provided Without Adequate Justification

Even though it is government policy that contractors provide their own material unless otherwise justified, the Air Force has routinely provided GFM to contractors without adequate evaluation or justification. This situation occurred in part because Air Logistics Centers (ALCs) have followed an outdated (1978) policy, which advocated providing GFM to contractors whenever possible, instead of the revised (1984) policy, which generally requires contractors to provide commercial material when available.

Even when commercial material was readily available, extensive amounts of GFM were provided to contractors because ALC personnel thought it was in the best interest of the government to do so for such reasons as economy and expedited production. However, they provided little or no evidence of any analysis supporting their decisions in specific contracting situations. It appears that contractors are allowed to buy material commercially (even when it costs less) only if their contracts

with the government contain unique contract provisions permitting them to do so.

### Controls Over Contractor GFM Requisitions Are Inadequate

Current Air Force procedures and practices for controlling the issuance of GFM to contractors are inadequate for the following reasons:

- The Air Force has not properly implemented an Air Force Logistics Command (AFLC) regulation that requires the identification of specific parts and quantities needed by contractors to execute maintenance contracts. As a result, contractors have had access to and have ordered unneeded material. For example, in 1986, the Air Force Audit Agency found that 33 of 180 requisitions reviewed were for items not required to complete contracts. The material was valued at \$334,000.
- Although the Air Force has established MCAs to control GFM requisitions on maintenance, production, and research and development contracts, it has not yet set a target date for implementing similar controls at the retail level. Contracts awarded at that level have not specified the amount and type of GFM authorized, and local Air Force officials have approved GFM requisitions without review.
- Some contractors have obtained GFM by accessing the supply source directly or by using military instead of contractor codes to requisition supplies, bypassing established Air Force checks. For example, in 1986, 161 GFM requisitions were filled by directly accessing the source of supply by computer. The GFM was valued at \$137,000. Of the 161 requisitions, 107—valued at about \$95,000—were determined to be improper.

### Control Over GFM at Contractor Facilities Inadequate

Government property administrators have not provided the oversight necessary to control GFM received and held by contractors at their facilities, as required by the Federal Acquisition Regulation and DOD guidance. In some instances, property administrators have not (1) independently verified the accuracy of contractors' GFM receipt records, (2) identified excess GFM in contractors' facilities, and (3) conducted the required annual property surveys of contractors' facilities.

Because of these deficiencies in oversight controls, the Air Force is unable to verify the amount of GFM contractors have received and the amount of excess GFM that remains with the contractors. For example, at Eglin Air Force Base, neither the contracting officer nor the acting property administrator knew that one contractor did not maintain records for GFM items valued at \$50 or less and had not determined whether this GFM was necessary to perform the contract. The contractor determined

that the value of the GFM inventory was \$4.4 million, of which about \$2.5 million (57 percent) was for items worth \$50 or less. Much of the \$4.4 million inventory may be in excess of needs. For example, 42 percent of 132 selected GFM items valued at more than \$50 had not been used in 1-1/2 years and 33 percent had not been used in at least 3 years.

### Inadequate Accountability and Financial Control Over GFM

DOD and the services have been criticized since 1967 for not having established independent financial accounting systems to provide accountability and control over GFM from receipt by a contractor to use on a contract or return to DOD. Although we recommended in 1980 (and DOD concurred) that such systems be established, the Air Force has not yet done so. As a result, the Air Force still does not have an independent means to identify how much GFM its contractors have on hand, how much is being provided annually, and how much is in excess of needs. The Air Force expects to have such data available by the fall of 1989.

### Recommendations

GAO recommends that the Secretary of the Air Force direct its commands to

- enforce existing regulations and policies requiring documentation and justification for using GFM,
- implement MCA controls at the retail level as soon as possible,
- validate wholesale-level contractor requisitions at the MCAs before they are filled,
- improve the accuracy and completeness of AFLC's data base, and
- conduct adequate annual surveys of contractors' property control systems.

### Agency Comments

DOD agreed with all of GAO's findings and recommendations and identified specific actions they plan to implement.

# Contents

<b>Executive Summary</b>		2
<b>Chapter 1</b>		8
<b>Introduction</b>	Government-Furnished Material	8
	Historical Problems in Managing and Controlling GFM	10
	Objectives, Scope, and Methodology	13
<b>Chapter 2</b>		16
<b>The Air Force Has Not Adequately Justified Providing Material to Contractors</b>	Lack of Compliance With Policy	16
	Disadvantages of Providing GFM	19
	Conclusions	20
	Recommendation	20
	Agency Comments	20
<b>Chapter 3</b>		21
<b>Air Force Controls Over GFM Are Inadequate</b>	Current Controls Over Material	21
	Weaknesses in Controls Over the Issuance of GFM to Contractors	23
	Air Force Actions to Correct Internal Control Problems	29
	Weaknesses in Controls Over GFM After Issuance to Contractors	30
	Financial Accountability and Controls	33
	Financial Integrity Act Statements Do Not Identify Control Weaknesses	34
	Conclusions	34
	Recommendations	35
	Agency Comments	36
<b>Appendix</b>		38
	Appendix I: Comments From the Deputy Assistant	38
<b>Table</b>		18
	Table 2.1: Comparison of One Contractor's Commercial Purchase Prices With DOD Catalog Prices	18



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**Abbreviations**

AFAA	Air Force Audit Agency
AFB	Air Force Base
AFLC	Air Force Logistics Command
AFLCR	Air Force Logistics Command Regulation
AFSC	Air Force Systems Command
ALC	Air Logistics Center
DCAS	Defense Contract Administration Service
DLA	Defense Logistics Agency
DOD	Department of Defense
DODAAC	Department of Defense Activity Address Code
DODI	Department of Defense Instruction
FAR	Federal Acquisition Regulation
FSC	Federal Supply Class
GFM	Government-Furnished Material
GSM	Government-Supplied Material
MCA	Management Control Activity
MUCO	Material Utilization Control Office

# Introduction

On May 23, 1986, we reported on problems in Department of Defense (DOD) inventory management practices.<sup>1</sup> As a result of that report, Senator Wilson, then Chairman of the Senate Armed Services Committee's Task Force on Inventory Management, requested that we identify the magnitude of those problems. Subsequently, Senator Glenn, Chairman, Senate Committee on Governmental Affairs, made the same request. One of the problems involved the adequacy of control over contractors obtaining government-furnished material (GFM) from the DOD supply system.

## Government-Furnished Material

GFM is material that may be incorporated into or attached to a deliverable end item or that may be expended in performing a contract. GFM includes parts, assemblies, and raw and processed materials used in the research, development, production, maintenance, and repair of such final products as tanks, aircraft, and ships. GFM is also used in support of various services provided by contractors at military installations.

Since, with few exceptions, GFM is provided without cost to contractors, it is not usually included in the contract prices. Once issued to a contractor, GFM is generally dropped from the government's inventory records, and the contractor maintains the government's accountable records for the material in its possession. Although the total amount of GFM currently in the hands of Defense contractors is unknown, the most recent available DOD data (September 30, 1980) showed that it was about \$14 billion.<sup>2</sup> Over \$5 billion of that total was associated with the Air Force.

As one means of accomplishing its mission, the Air Force contracts with private companies to produce, maintain, and repair its equipment and to provide various services in support of Air Force installations worldwide. In some cases, the Air Force elects to furnish from Defense inventories some or all of the parts and other materials necessary to perform the contracts. The Air Force Systems Command (AFSC), for example, uses GFM in some of its contracts for developing and producing new weapon

<sup>1</sup>Inventory Management: Problems in Accountability and Security of DOD Supply Inventories (NSIAD-86-106BR, May 1986).

<sup>2</sup>In a hearing on March 6, 1985, we testified before the House Government Operations Committee that this figure was probably understated. On February 6, 1987, we asked DOD for an update of this figure. However, on April 9, 1987, DOD replied that while such data had not been collected by DOD and the services, actions were underway to do so. In February 1988, DOD provided us with its results. DOD estimated that as of September 30, 1986, the DOD total had grown to about \$16.1 billion and the Air Force total to about \$6.0 billion. DOD also informed us that the totals included material acquired by contractors from commercial sources with government funds.

systems. Similarly, the Air Force Logistics Command (AFLC) sometimes authorizes GFM in its contracts for maintenance and repair of end items and components. Also, other Air Force major commands and bases authorize providing GFM to contractors for services such as operating test ranges, base supply systems, and base security operations.

To enable contractors to obtain GFM, the Air Force currently assigns them six-digit codes, called DOD Activity Address Codes (DODAACs), which allow access to the DOD supply system. The Air Force has assigned over 3,000 of these codes to various contractors. Contractors can use their DODAACs and follow standard DOD requisitioning procedures to obtain materials directly from wholesale-level inventories.<sup>3</sup> Contractors can also obtain material by (1) ordering from retail-level base supply activities, which replenish their stocks from the wholesale inventories, or (2) buying from commercial sources using Air Force funds.

The Federal Acquisition Regulation (FAR) sets forth the general policy that while contractors shall ordinarily furnish all material required for the performance of government contracts, GFM should be provided to a contractor when it is in the best interest of the government. The FAR and DOD and Air Force regulations require that decisions to provide GFM be justified in writing.

The FAR and individual contract provisions specify contractor and government responsibilities for accounting for, controlling, protecting, preserving, maintaining GFM. To meet their responsibilities, contractors are required to establish and maintain property control systems that are subject to review and approval by the government's property administrators. The property administrators are to perform annual surveys of the contractors' property control systems covering 10 categories, ranging from acquisition, use, and consumption to receiving and recordkeeping.

<sup>3</sup>For purposes of this report, wholesale-level inventories refer to materials managed by inventory control points for distribution to retail-level activities such as air bases and air stations. They include materials managed by all the military departments as well as the Defense Logistics Agency and the General Services Administration.

## Historical Problems in Managing and Controlling GFM

Since 1967, GAO, Defense, and Air Force audits have identified significant problems in the DOD and Air Force management and control of GFM. Following are some of the problems noted since 1976:

- In 1976, Air Force contractors ordered GFM directly from government supply systems and received direct shipments with little or no Air Force oversight. Also, contractors' consumption of GFM could not be compared against expected or planned use rates, because material requirements lists provided by the Air Force to contractors were incomplete and/or inadequate.<sup>4</sup>
- In 1976, material management procedures on one base maintenance contract did not provide adequate control and could not preclude misappropriation of GFM. This lack of control occurred despite general compliance with Air Force regulations, and therefore this situation could exist at other Air Force locations.<sup>5</sup>
- In 1976, a Defense Supply Agency (now Defense Logistics Agency) audit of the adequacy of DOD and 66 contractors' controls over GFM concluded that (1) the contractors' handling of GFM needed to be improved, (2) government surveillance of contractors' property control systems was inadequate, and (3) government property administrators did not receive sufficient guidance to effectively review contractor property control systems. The audit report also identified numerous abuses of GFM, including the use of GFM on commercial contracts, use of improper priority designators (which are assigned to requisition GFM on the basis of criticality of need), acquisition of GFM in excess of contractual needs, and omission of GFM on contractor stock records.<sup>6</sup>
- In 1978, the Defense Audit Service (now part of the Office of the DOD Inspector General) reported on long-standing deficiencies in (1) the acquisition and use of GFM by contractors and (2) the government's surveillance of the contractors' property control systems. The report concluded that in view of these deficiencies, DOD should limit contractors' access to the DOD supply system and require contractors to finance inventories of material.<sup>7</sup>
- From 1978 to 1981 the Air Force Audit Agency (AFAA) reported that

<sup>4</sup>Second GAO Report on Need for Better Control Over Government Furnished Material Provided to Defense Overhaul and Repair Contractors (PSAD-76-78, Mar. 1976).

<sup>5</sup>Better Management of Government-Furnished Material Could Decrease Cost of Base Maintenance Contracts (PSAD-76-79, Feb. 1976).

<sup>6</sup>Audit of Government-Owned Material at Selected Overhaul and Maintenance Contractors (Report No. 77-40, Oct. 1976).

<sup>7</sup>Administration of Maintenance, Overhaul, and Repair Contracts (Report No. 890, May 1978).

- a lack of visibility and control allowed maintenance contractors to requisition \$1.3 million of unneeded GFM;<sup>8</sup>
- contractors could bypass Air Force controls and submit requisitions for material directly to the source of supply without being detected;<sup>9</sup> and
- contractors could requisition and receive unauthorized GFM by coding requisitions with invalid data (contract number, fund code, or activity address code) because existing procedures did not require material management personnel located at Air Logistics Centers (ALCS) to match GFM shipments with requests made by other ALCS.<sup>10</sup>

The lack of accountability and control over GFM and the concomitant abuses were also discussed during a House Appropriations Committee hearing on the fiscal year 1979 Defense appropriation request. The subsequent Committee report (No. 95-1398), issued on July 27, 1978, questioned the practice of providing maintenance contractors with almost limitless authority to requisition GFM. The Committee requested that DOD test a system that would allow contractors to use the DOD supply system, but would require them to pay for requisitioned materials. Subsequently, DOD tested this concept, but because of contractors' reluctance to participate due to perceived higher financial risk, the Deputy Assistant Secretary of Defense for Logistics and Material Management recommended that the services not adopt the system. He recommended that some alternative means be used to control contractors' access to the DOD supply system.

In June 1979, the Director of the Office of the Secretary of Defense's Supply Management Policy started drafting DOD Instruction (DODI) 4140.48, as well as a revision to the DOD Military Standard Requisitioning and Issue Procedures, which addressed the issue of control over GFM. The instruction, "Control of Access to DOD Material Inventories by Maintenance Contractors," issued in March 1981, directed each DOD component to establish one or more Management Control Activities (MCAs) to maintain central control over all maintenance contractors' access to the DOD supply system by reviewing, validating, and approving requests for GFM. (see ch. 3 for a detailed description of MCA functions.)

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<sup>8</sup>Management of Depot-Level Contract Maintenance (June 1978).

<sup>9</sup>Computer Controls Over Material Furnished to Defense Contractors (June 1978).

<sup>10</sup>Air Force Managed Sensitive and Pilferable Items (Mar. 1981).

In October 1981, the Legislation and National Security Subcommittee of the House Committee on Government Operations held a hearing to determine what progress DOD and the services had made in improving GFM management. During this hearing, DOD officials reported on the actions taken and planned to prevent future instances of unauthorized access to and misuse of GFM and unsatisfactory GFM accountability and control. The Committee recommended that DOD develop a plan of action as soon as possible to install adequate controls over GFM.

The House Committee on Government Operations held another hearing in March 1985 on GFM provided to defense contractors and, in its May 1985 report, recommended, among other things, that (1) DOD efforts to install appropriate accounting controls over GFM be accelerated, (2) plans for implementing the MCA concept contained in DODI 4140.48 be expedited and the control requirements be extended from maintenance to production and supply contractors, and (3) the concept of selling material to contractors instead of providing it free of charge be retested.

Subsequent to the Committee's report, AFAA reported that (1) Air Force maintenance contractors bypassed existing MCA controls and requisitioned and received unauthorized and unneeded materials, (2) contractors failed to cancel outstanding GFM orders (back orders) after contracts were completed, and (3) an expensive computerized system to monitor and control GFM held by maintenance contractors was ineffective.<sup>11</sup>

In March 1986, DODI 4140.48 was reissued and extended to cover all types of contracts, including both base and centrally awarded service, production, and research and development contracts. DOD plans to implement the new instruction in phases, starting with research and development and production contracts awarded at the wholesale level—inventory control points and ALCS—before going on to service contracts awarded at the retail level—units and installations.

In DOD's December 30, 1986, report to the Congress on how well it was meeting the objectives of the 1982 Federal Managers Financial Integrity Act, certain GFM internal control weaknesses in the Air Force were noted. Specifically, the report said that the Air Force had not adequately reported and controlled GFM because authorizations were not properly computed and on-hand material balances were overstated. The Air Force recognized that accounting for GFM was an accounting system

<sup>11</sup>Internal Controls Within Systems for Managing Material Furnished to Maintenance Contractors (Jan. 1986).

deficiency. These weaknesses are expected to be corrected by October 1988.

In February 1987, AFAA completed a report on its evaluation of Air Force control over GFM provided to contractors on maintenance, research and development, and production contracts.<sup>12</sup> The audit assessed (1) the accuracy of contractor GFM records, (2) the adequacy of Air Force efforts to establish independent accountability and control of GFM at contractor facilities, (3) the cost-effectiveness, accuracy, and completeness of GFM transaction reporting systems, and (4) the adequacy of Air Force administration/surveillance over GFM at contractor facilities.

Based on its audit work at several major Air Force commands, three ALCS, and six contractor locations, AFAA identified several areas where GFM controls could be improved. Specifically, the agency noted that (1) the GFM transaction reporting system was not providing accurate and timely information, (2) controls limiting contractor access to DOD material inventories for research and development and production contracts were not effective, and (3) implementation of the Air Force GFM financial accountability system had slipped and could be further delayed because of unresolved issues. The report also identified GFM problems at contractor locations, such as excess GFM valued at \$1.3 million at four of the six locations reviewed, the transfer of about \$14 million of GFM assets to other contracts without Air Force assessment of the appropriateness of this action, and the commingling of contractor material with GFM.

## **Objectives, Scope, and Methodology**

Our objectives were to (1) determine if the Air Force had properly implemented the FAR and DOD and Air Force policy requirements to justify and document decisions to provide material to contractors, (2) evaluate the adequacy of management controls established to validate and approve contractor GFM requisitions, and (3) assess the adequacy of controls over GFM at the place of contract performance.

To determine if the Air Force adequately justified and documented the need to provide GFM, we visited three ALCS, three Air Force bases, and one Air Force station. At these locations, which were judgmentally selected, we discussed with responsible officials their rationale for providing GFM and evaluated, to the extent they were available, written GFM justifications for selected contracts.

<sup>12</sup>Government-Furnished Material at Contractor Facilities (Project No. 6076410, Feb. 1987).

To evaluate controls over contractor access to the DOD supply system, we interviewed responsible officials and examined pertinent records at the three ALCS. We also met with government officials responsible for property administration at the Air Force bases, the Air Force station, and five contractor locations to determine the adequacy of their reviews of contractor property control systems.

Our review focused on maintenance contracts awarded by the ALCS and service contracts awarded by Air Force bases and installations. We did not include AFSC production or research and development contracts because of an ongoing AFSA review of this area.

We also visited selected contractors to review their procedures for determining GFM requirements and for identifying and returning excess GFM to the supply system. We conducted our audit work between April 1986 and July 1987 at the following locations:

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**U.S. Air Force**

- Headquarters, Air Force Logistics Command, Wright-Patterson Air Force Base, Ohio;
- Warner-Robins Air Logistics Center, Robins Air Force Base, Georgia;
- San Antonio Air Logistics Center, Kelly Air Force Base, Texas;
- Oklahoma City Air Logistics Center, Tinker Air Force Base, Oklahoma;
- Eglin Air Force Base, Florida;
- Patrick Air Force Base, Florida;
- Nellis Air Force Base, Nevada; and
- Arnold Air Force Station, Tennessee.

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**Defense Logistics Agency**

- Defense Contract Administration Services Plant Representative Office, Hayes International Corp., Birmingham, Alabama;
- Defense Contract Administration Services Management Area, Orlando, Florida; and
- Defense Automatic Addressing System Office, Gentile Air Force Station, Ohio.

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**Contractors**

- Aero-Dri Corporation, Delray Beach, Florida;
- Hayes International Corp., Birmingham, Alabama;
- Honeywell Corp., Clearwater, Florida;
- RCA Service Company, Eglin Air Force Base, Florida; and
- Schneider Services International, Arnold Air Force Station, Tennessee.



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We did not evaluate internal controls in the Air Force automated data systems, which report the total GFM and excess GFM held by maintenance contractors, because the AFAA had recently reviewed and reported on this area. Data from these systems is presented in chapter 3 of this report to indicate the potential magnitude of GFM held by Air Force contractors. Because the number of our work locations was limited and they were not randomly selected, the findings in this report are not necessarily representative of the entire Air Force or all its contractors.

Our work was conducted in accordance with generally accepted government auditing standards.

# The Air Force Has Not Adequately Justified Providing Material to Contractors

Unless otherwise justified, it is government policy that contractors provide the material necessary to accomplish their contracts.<sup>1</sup> However, the Air Force has not followed this policy and has routinely provided GFM, including commercially available items, without adequate evaluation or justification.

Under certain circumstances, making exceptions to the general policy of using contractor-furnished material may be advantageous to the government. If, for example, the Air Force has an oversupply of a particular part needed for a maintenance contract, it would likely be prudent to provide the part as GFM rather than have the contractor buy identical parts and include the cost in his contract. Similarly, if a contractor needs a part that is unique to the military or not readily available from commercial sources, the Air Force may need to provide the part as GFM.

DOD policy contained in DODI 4140.48 and DODI 4100.33 (Commercial Activities Program) and AFLC policy in AFLC Regulation (AFLCR) 66-8, dated April 1984, state that exceptions to the basic FAR policy requiring contractors to provide all material necessary to accomplish their contracts should be supported by sound rationale and documented in writing for future reference. AFLCR 66-8 also states that materials readily available from commercial sources should be furnished by contractors.

## Lack of Compliance With Policy

The Air Force activities we visited were generally not complying with the above policy. We requested the GFM justifications for selected service contracts at Arnold Air Force Station and at Eglin, Nellis, and Patrick Air Force Bases, but none had been prepared. These contracts included such services as operating test ranges, maintaining real property, and operating data processing systems. Contracting personnel stated that the standard practice over the years has generally been to provide all materials to base contractors free of charge. For example, at Arnold and Eglin the material provided included a contractor-determined 60-day supply of paint, lumber, common hardware, car wax, office supplies, padlocks, and videotapes.

We also asked to review written GFM justifications for selected maintenance contracts awarded by the three ALCs we visited. The ALCs had not prepared detailed analyses and written justifications in most cases.

<sup>1</sup>The FAR states that contractors will furnish all material required for the performance of government contracts. The FAR further provides, however, that agencies should furnish material to a contractor when it is determined to be in the best interest of the government for reasons of economy, standardization, expedited production, or other appropriate circumstance.

- Production management specialists at the San Antonio ALC, who normally make the decision to provide GFM, had not prepared written GFM justifications for any of the 13 contracts we examined. None of the five specialists was aware that written justifications were required.
- Similarly, there were no detailed analyses or written justifications to support the use of GFM on any of the five contracts we examined at the Warner-Robins ALC. Warner-Robins ALC officials stated that the same was true for its remaining 196 maintenance contracts.
- Oklahoma City ALC personnel provided a written GFM justification for the single, sole-source contract we examined there. However, the ALC had a written policy of providing GFM on all competitive contracts. This policy was followed, according to ALC officials, to ensure that small businesses were not at a disadvantage when competing with large businesses, because large businesses usually have material purchasing departments whereas small businesses do not.

These situations occurred in part because the ALCs were following an outdated regulation. A San Antonio ALC official told us, for example, that parts available in the DOD supply system are normally provided as GFM because the Air Force could be criticized for not providing them and causing a contractor to procure additional parts at higher prices. This practice is consistent with an earlier version of AFLCR 66-8, dated May 1978, which stated that the government would normally provide all items of material that are centrally managed, including Air Force, Defense Logistics Agency, and other services' stock fund items. This regulation was apparently based on the assumption that providing material from inventory would be in the best interest of the government and thus would comply with the FAR.

The 1984 revised AFLCR 66-8 requires maintenance contractors to provide readily available commercial material whenever possible. Nevertheless, personnel at the ALCs still generally provided extensive amounts of GFM, and they gave several reasons for doing so, including the following:

- Contractors can bid on equipment repairs without having to worry about the quantities and condition of the equipment to be maintained or repaired and the types and amounts of material that will be needed. Furthermore, the government often does not accurately know what quantities of items need repair.
- Flight safety considerations require use of parts with specific, known performance characteristics.

**Chapter 2**  
**The Air Force Has Not Adequately Justified**  
**Providing Material to Contractors**

- Requiring contractors to furnish material could restrict competition because small businesses may not have the funds to finance material inventories.
- Government parts, ordered in large quantities, are less expensive than commercial purchases in small quantities.
- Procurement lead-time problems are avoided because the parts are in stock.

These conditions may provide valid reasons for offering GFM in specific contracting situations. However, we found little evidence of any analysis showing they applied to specific contracts. For example, the common assumption that items in the government inventory cost less than those that would be purchased by a contractor is not always true. When the Air Force authorized a contractor to buy air compressor access doors commercially because they were not in stock in the DOD supply system, where the doors were priced at \$253 each, the contractor was able to buy 18 doors for \$21 each.

Another contractor was also able to obtain material commercially at a lower price than was available at the DOD source of supply. The contractor was required in his cost-plus-award fee base operations contract, valued at over \$345 million over 5 years, to identify the most economical source and either buy the parts commercially and be reimbursed or requisition them from the DOD supply system. During fiscal year 1986, the contractor obtained about 90 percent of his \$16.4 million of material items from commercial sources. Table 2.1 provides examples of lower cost, commercially acquired materials.

**Table 2.1: Comparison of One Contractor's Commercial Purchase Prices With DOD Catalog Prices**

Item	National Stock Number	DOD catalog price	Commercial price	Price difference
Switch	5930-01-210-4061	\$110.88	\$71.96	\$38.92
Connector	5935-01-223-9354	15.33	2.98	12.35
Microcircuit	5962-01-043-1642	2.24	0.86	1.38
Transistor	5961-00-949-1440	1.18	0.29	0.89
Terminal board	5940-00-983-6049	2.37	0.67	1.70
Tube	5960-00-338-9164	217.22	97.00	120.22

## Disadvantages of Providing GFM

Providing GFM to contractors can be advantageous to the government; however, there can also be disadvantages. First, provisions in Air Force contracts authorizing GFM require contractors to use GFM when it is available and to resort to commercial purchases only when GFM is not available or cannot be furnished from government stocks in time to prevent schedule slippages. Under such provisions, contractors must use GFM even when materials are available at a lower price commercially. The contractor who bought the access doors commercially was allowed to do so only because the doors were not in stock in the DOD system. The other contractor was able to buy commercially because of unique contract provisions.

Second, contractors face no financial risks in using GFM and have no incentive to minimize its use. Since GFM is not financed by contractors, they experience no penalty for overordering and overstocking it. Also, if the contractor returns excess GFM, the government pays transportation costs. According to AFLC data, between fiscal years 1982 and 1986, excess GFM had accumulated on 34 to 46 percent of all maintenance contracts.

In some cases, contractors may be inclined to order more than reasonable amounts of GFM to preclude material shortages that could affect contract performance. For example, a contractor that operated the test range at Eglin AFB received a variable award fee based on a semiannual performance evaluation, which placed little weight on effective management of GFM. For the period from April to September 1986, the contractor received a poor rating for its property control system, partially because of excessive GFM use, but still received an overall rating of excellent and was granted an award fee of \$436,757, which was 95 percent of the maximum possible award fee. Eglin's Armament Division, which granted the award fee, placed emphasis on responsiveness to mission requirements in deciding how much to award, not on how effectively the contractor managed GFM.

Third, accounting for and controlling GFM at contractor locations is difficult and costly. For example, after a review of 15 contracts, the AFAA reported in 1987 that total direct costs associated with Air Force GFM reporting requirements were \$526,183. The AFAA report showed that the Air Force had incurred this cost to collect GFM data, but the data was incomplete, inaccurate, and did not provide real-time visibility over GFM at contractor facilities. Further, the long-standing problem of controlling contractors' access to the DOD supply system has yet to be solved (see ch. 3).

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## **Conclusions**

To comply with the FAR and with DOD and Air Force implementing regulations, the Air Force should require contractors to furnish and finance the materials necessary for their contracts except when it is determined through specific analysis that providing GFM is advantageous to the government. The Air Force should also ensure that the determinations to provide GFM are based on sound rationale and are documented for future review. The Air Force activities we reviewed were generally not complying with written policies for authorizing and justifying GFM. On the contracts reviewed, the activities had routinely authorized GFM but generally had no documentation or analyses to justify providing GFM to the contractors.

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## **Recommendation**

We recommend that the Secretary of the Air Force direct all Air Force commands and activities to enforce compliance with the existing FAR and DOD and Air Force policies regarding GFM which, among other things, require that decisions to allow contractors to obtain GFM are justified in advance, in writing, and are adequately documented to demonstrate that they are in the government's best interest from a cost-effectiveness or other critical standpoint.

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## **Agency Comments**

DOD agreed with our recommendation. DOD stated that its policy clearly requires justification prior to providing GFM to contractors and it will ensure that Air Force management staffs at all levels emphasize compliance with the policy.

DOD noted that in June 1987 AFLC implemented a supplement to the FAR that requires procurement contracting officers and system program managers to certify the need for providing GFM to contractors and to place this certification in the contract file. DOD added that Air Force headquarters and Inspector General inspection visits will be made to ensure compliance.

# Air Force Controls Over GFM Are Inadequate

Although the Air Force has taken steps to implement DOD instructions designed to control GFM more effectively, it still does not have adequate controls to ensure that its contractors requisition, receive, and consume only needed items and amounts of GFM. The Air Force needs to improve its controls over the issuance and use of GFM. Specifically,

- the Air Force has management control activities for controlling GFM requisitions on wholesale-level maintenance, production, and research and development contracts, but has not yet established a target date for implementing such controls for contracts awarded at the retail level;
- Air Force procedures for validating and approving maintenance contractor requisitions do not limit contractors' requisitions of GFM to the specific parts and quantities required for contract purposes;
- GFM requisitions submitted by retail-level contractors were not reviewed or approved by Air Force officials because the contracts did not specify the items and amounts the contractors were authorized to receive;
- some contractors obtained material from the DOD supply system without having been identified as contractors, which resulted in GFM requisitions bypassing established checks and edits;
- certified government property administrators had either not been designated or did not adequately review contractor property control systems to ensure that the government's interests were properly protected.

Air Force reports on internal control weaknesses, which are required under the Federal Managers Financial Integrity Act, did not identify and report the control weaknesses we found, and existing Air Force accounting systems do not provide adequate identification of or control over the total amount of GFM provided to contractors.

DOD and the Air Force have been aware of many of these problems for some years and have initiated actions to minimize them, but their actions have not fully resolved the long-standing problems in accounting for and controlling GFM.

## Current Controls Over Material

In March 1981, DOD issued DODI 4140.48, "Control of Access to DOD Material Inventories by Maintenance Contractors." The instruction applied only to items acquired by maintenance contractors hired by DOD wholesale-level organizations and excluded material provided in support of other contracts awarded at the wholesale level, such as production and research and development contracts, as well as service contracts awarded at the retail level—military bases, posts, camps, or stations.

Specifically, the instruction required the DOD components to establish one or more automated internal control mechanisms, called management control activities (MCAs). The MCAs were to

- screen all maintenance contractor requisitions by specific stock number or stock class for validation and approval,
- reject all requisitions that do not comply with contract terms, and
- pass approved requisitions to appropriate DOD sources for supply action.

In addition, the MCAs were to establish a management reporting system that

- maintains a contract, requisition, and shipment status history file to serve as an auditable record of GFM transactions;
- provides DOD contract administration offices with a semiannual report of material shipments to contractors and the number of requisitions rejected; and
- provides the Assistant Secretary of Defense for Acquisition and Logistics a status report reflecting the number and dollar value of GFM requisitions filled from assets in long supply.

The DODI was revised on March 6, 1986, and its scope expanded to include the screening of material requests from all other types of contractors, such as production, research and development, and service contractors. The revised instruction also included the following changes:

- The MCAs will establish the maximum number of items a contractor can obtain.
- The MCAs no longer need to report the number and dollar value of requisitions filled from assets in long supply.

DOD expected the services to implement the revised instruction in phases, starting with maintenance and production contracts awarded at the wholesale level before going to retail-level contracts. MCAs and MCA equivalents have been established for maintenance, production, and research and development contracts awarded at the wholesale level, but they have not yet been established for service contractors operating at the retail level. A target date for full implementation has not been established.

For wholesale-level maintenance contracts, the Air Force's implementing regulation (AFLCR 66-8) established MCAs that performed computer edits



of the contract number, GFM code,<sup>1</sup> and Federal Supply or Stock Class (FSC),<sup>2</sup> all of which must be passed before requisitions from contractors are filled. Appendix B of each maintenance contract directs the contractor to process all requisitions through the ALC that funded the contract. The funding ALC's Special Support Stock Control and Distribution System (DO34A) and Accounting System for Industrial Fund Procurements for GFM (HO75C) contain the edit tables for its valid contracts. Contractor requisitions that are properly processed are compared to the system edits, coded as authorized contractor requisitions, and passed through the Defense Automatic Addressing System Office to the appropriate source of supply. When requisitions are passed to the source of supply, the ALCs' DO34A and HO75C control systems establish document control records for the transactions. All subsequent actions or status provided from the source of supply to the funding ALC should correspond to a document control record. If they do not correspond, the transactions appear on the DO34A report (Shipment/Supply Status-No Matching Contractor Requisition). This report indicates that something may be wrong within the GFM control system for the listed transactions.

For production and research and development contracts, Air Force Manual 67-1, "Supply Management," established MCA equivalents, called Material Utilization Control Offices (MUCOs). The MUCOs are responsible for verifying that all Air Force production and research and development contractor requisitions are contractually authorized and approved prior to shipment.

We found no specific guidance for controlling requisitions from contractors working at military installations on contracts awarded at the base level. Local Air Force officials rely on general internal control guidance in the FAR and specific contract provisions, which may vary from contract to contract.

## Weaknesses in Controls Over the Issuance of GFM to Contractors

Current Air Force procedures and practices for reviewing, validating, and approving GFM requisitions allow contractors excessive access to the DOD supply system because (1) AFLC edits based on FSC are insufficient to control maintenance contractor requisitions, (2) a computer edit deficiency (which has recently been corrected) automatically changed erroneous stock classes in a way that permitted contractors access to

<sup>1</sup>This code indicates whether or not GFM is authorized on the contract.

<sup>2</sup>FSCs contain thousands of national stock numbers. Each stock number represents a specific item or part.

unauthorized items, (3) the MCA system does not limit quantities of GFM issued to those needed to perform a contract, (4) contractors bypass established edits, (5) contracts are modified without formal approval by the contracting officers, (6) MUCOS do not verify all production and research and development contractor requisitions to ensure that they are contractually authorized, and (7) base-level contractor requisitions are not always reviewed or approved by local Air Force officials because the contracts do not specify the material contractors were authorized to obtain.

### Edits Based on Stock Class Insufficient

Air Force maintenance contracts generally do not specify items and quantities of material the government has agreed to furnish to contractors. Instead contractors are authorized access to all material in various FSCs, which are generally listed in appendix B of a contract.

The current AFLC practice intended to control maintenance contractor requisitions is to verify that the items requested are within the authorized FSC. This practice (1) does not meet the AFLC Regulation 66-8 requirement that ALCS will list specific items or parts and quantities of authorized GFM in contracts and screen requisitions under those contracts against the listing and (2) gives contractors access to thousands of items not needed to accomplish the contract.

On one contract, for example, only 22 specific, stock-numbered parts were required to repair the end item (a F-100 engine combustor). However, the contractor could requisition any item from the 10 different stock classes in which the 22 parts were contained. Within the 10 classes there are over 349,000 other parts that are not needed to repair the end item. Nevertheless, the contractor could requisition any of these unneeded parts, in any quantity, and the improper requisition could pass through the AFLC screening system and be approved.

We did not determine whether this contractor had requisitioned any unneeded parts because of the amount of time and effort needed to do so, and we are not suggesting that the contractor may have done so. However, AFAA reported that contractors have obtained unneeded and unauthorized parts. In its 1986 report on the effectiveness of internal controls on GFM provided to maintenance contractors, AFAA stated that the automated systems did not edit specific stock numbers required for repairing items and 33 of the 180 requisitions reviewed were for items not required to repair the items in the contracts. The unauthorized,

unnneeded requisitions were for 637 units of material valued at \$334,000.

Personnel at the three ALCs we visited told us that the major obstacle to complying with AFLC Regulation 66-8 has been and continues to be the inaccuracy of the parts lists making up an end item (full-range lists), which identify the specific items and quantities of GFM to be authorized. Although AFLC had developed a system by March 1986 to screen and approve requisitions by item and quantity, the three ALCs we visited were not using it because of its inaccuracies. Success of the screening system is dependent on having accurate information with which to identify items and quantities needed. The Air Force tested the system (Equipment Requirements Listing - D049 system) that will supply item and quantity data at the Sacramento ALC and found the data to be 100 percent accurate. However, our tests of the D049 system indicated that the ALC's concerns about accuracy were well founded. For example, of the 26 full-range lists we examined for a contract awarded by the Warner-Robins ALC, six did not have any parts listed, and for the remaining 20 listings, only 51 percent of the parts listed had stock numbers identified. (We did not attempt to reconcile the difference between the Air Force test and our own.) Because of such inaccurate data, the ALCs continue to write contracts referencing stock classes instead of stock numbers.

### Computer Edit Allowed Access to Unauthorized Items

Further compounding the edit problem has been a computer edit deficiency at the Defense Automatic Addressing System Office that permitted contractor access to almost the entire DOD supply system, which includes about 4.5 million active stock numbers. To illustrate, if a contractor wanted to obtain computer floppy disks, stock number 7045-01-138-8026, which were not authorized as GFM, the contractor could submit a requisition using the last nine digits with an inaccurate stock class number, for example 2840—jet aircraft engines and components—and the computer edit would automatically change the 2840 stock class to the 7045 stock class for automatic data processing supplies, and route the requisition to the appropriate source of supply to be filled.

Between July 1986 and June 1987, over 345,000 automatic corrections were made by the Office, including almost 42,000 that were Air Force related. DOD directed that the automatic correction feature be discontinued effective September 1, 1987.

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## System Fails to Control Maximum Issue Quantities

The MCA system currently has no checks to prevent a contractor from exceeding maximum quantities needed to perform the contract. Also, contractors can avoid edits designed to prevent Air Force units and contractors from depleting wholesale stock levels. For example, one contractor had requisitioned connector jacks 45 times on the same day, for a total of 855 jacks valued at \$333.45. (The contract limited the contractor to 90 jacks.) The contractor avoided the maximum quantity edit of 20 jacks by ordering 19 parts on each request. Had 20 jacks been ordered, the requisition would have been flagged for management review.

The absence of effective controls over quantities issued contributes to excess material accumulating at contractor plants. The Warner-Robins ALC, for example, reported excess stock on 69 contracts that totaled approximately \$9.1 million as of May 31, 1987. An official in AFLC's Directorate of Material and Production Support declined to provide similar data for all ALCs because he considered the figures to be inaccurate. According to the official, the actual excess may be higher or lower than the reported amounts due to programing flaws in the excess reporting system. He said that the AFLC currently has no system to collect reliable data to show how much excess material is at contractor plants. According to another AFLC official from the Directorate of Maintenance, AFLC has recognized that an accurate excess reporting system is needed and is seeking alternatives to the current system. He projected that this effort would be completed by September 1989.

Although the Air Force does not know the amount of excess GFM on hand at contractor plants, it can be substantial. For example, one contractor had \$4 million in excess GFM on hand from a contract with Warner-Robins for repairing C-130 aircraft. This excess had been reported by the property administrator at the plant.

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## Contractors Bypass Established Edits

Deficiencies in internal controls allowed contractors' requisitions to bypass established edits. These bypasses occur when (1) a maintenance contractor omits specific required coding in its GFM requisition, which allows it direct access to the source of supply, or (2) the Air Force assigns military unit activity address codes to contractors.

AFAA found instances of Air Force maintenance contractors bypassing all computer system edits involving the contract number, GFM authorization code, and FSC by directly accessing the source of supply by computer.

For example, according to the 1986 AFAA report, 161 contractor GFM requisitions valued at about \$137,000 were filled in this fashion. Of these 161 requisitions, 107 valued at about \$95,000 were determined to be improper and were referred to the Air Force Office of Special Investigation for further assessment.

We also found numerous instances of contractors' requisitions bypassing edits. However, we could not determine the frequency of such actions or the total value of GFM obtained in this way because (1) the ALCS did not use and had not kept copies of a monthly GFM contractor shipment supply status report (D034A) or a financial report showing the value of each contract (G072D), which could have identified contractors that may have bypassed existing edits, and (2) reconstructing the required data would have been impractical because of the volume of requisitions involved.

The D034A is based on data developed by contractors and provides item-by-item information on the quantities and values of GFM on hand, used, and potentially excess. Since there are no edits or controls on quantities, this report could serve as a source of data for early identification of excess GFM resulting from a contractor ordering more than is actually needed. We found that this report was generally not used by ALC program management specialists because the data requires extensive manual review, and they claimed that the report was inaccurate and incomplete and was not reported on a usable "real-time" basis.

Another potential control for monitoring GFM is the G072D system. This data system reports monthly information on the cost of GFM provided to contractors. This is the only financial data available for monitoring costs associated with GFM going to a contractor's facility, since contracts provide no GFM cost data. The system should alert the program management specialists that the cost of GFM has exceeded budget estimates. However, they were not using this system because they did not understand the report format or the data.

We also found that the Air Force violated standard DOD military requisitioning and issue procedures by assigning military unit DODAACS to at least 21 major contractors. Contractor GFM requisitions are thus treated as Air Force unit requisitions and, as such, bypass all edits specifically established to control contractor requisitions.

Air Force officials explained that military DODAACS were assigned to contractors to streamline the requisitioning process. For example, in one

contractor's case they noted that the use of a contractor DODAAC resulted in the cancellation of numerous legitimate GFM requisitions. Their solution was to provide the contractor with a military DODAAC. However, this "solution" did not address the real problem, which was that Arnold Air Force Station had not provided copies of contract documents authorizing GFM requisitions to the appropriate Air Force ALCs and the contract did not specify what GFM the contractor was authorized to obtain.

### GFM Authorizations Modified Without Formal Approval

According to the FAR, contracting officers are to approve, in writing, any modification to the original contract. However, we found that at least two contracts were being modified without formal approval at the Warner-Robins ALC. One contractor was originally authorized to obtain parts from 168 stock classes. However, ALC production management staff approved GFM requisitions for an additional 27 stock classes without obtaining formal approval from the contracting officer, who would then have to modify the contract. Another contractor was authorized to obtain GFM from 125 stock classes but obtained GFM from 142. During the period of November 1, 1985, to October 31, 1986, these contractors obtained about \$102,000 and \$620,000, respectively, of GFM not specifically authorized by their contracts.

Warner-Robins ALC contracting officials pointed out that the parts from the additional stock classes were needed to support the contracts and that the action of the production management staff expedited the GFM requisitioning process. However, they agreed that the contracting officer should have been notified and the contracts modified to reflect the authorization of the additional stock classes. They stated that the current practice would be discontinued immediately.

### MUCOs Not Verifying Contractual Authority to Requisition GFM

According to a 1987 AFAA report,<sup>3</sup> ALC MUCOs, which serve as MCAs for research and development and production contracts, were not verifying all contractor requisitions to ensure that they were contractually authorized and approved prior to shipment. The Agency reported that the MUCOs had approved 90 requisitions, valued at \$2.7 million, in a sample of 144 contractor requisitions, valued at \$6 million, without verifying contractual authority to requisition GFM because they did not have copies of the authorized GFM material lists in the contracts.

<sup>3</sup>Government Furnished Material At Contractor Facilities (Air Force Audit Agency Report No. 6076410, Feb. 10, 1987).

In commenting on our draft report, DOD noted that AFLC sent a letter on May 28, 1987, to the ALCS to reiterate the need for strict compliance with existing policy and the need to stress the release of only those items on the GFM master list for each contract. DOD stated that enforcement would be accomplished through reviews by the AFLC Inspector General.

### Base-Level Contractor Requisitions Not Reviewed

Generally, retail-level base contractors depend on base supply offices to stock materials with which to support their contracts. The contractors requisitioned materials from these base supply offices. At Eglin Air Force Base and Arnold Air Force Station, base supply clerks reviewed the requisitions for administrative accuracy, but no one reviewed them to verify that the items and quantities ordered were necessary to perform the contract. The total amount of GFM obtained by base contractors can be substantial. For example, at Arnold, GFM requisitions processed for one contractor totalled \$1.6 million during fiscal year 1986.

One reason for the lack of review of GFM requisitions appears to be the lack of specificity in base contracts. We noted that the contracts we reviewed did not specify the material needed by the contractor to accomplish his work. Contracts generally stated only that the government would provide the necessary material. Air Force officials agreed that this was the case.

### Air Force Actions to Correct Internal Control Problems

AFLC officials stated that effective internal controls over GFM provided to their contractors have not been achieved, but noted that several corrective actions are underway at AFLC and its five ALCS where the MCAS operate. The Air Force believes that these initiatives will improve internal controls over the GFM requisitioning process. Three initiatives are discussed below.

- In March 1985, AFLC programmed the Special Support Stock Control and Distribution System (D034A) and the Master Material Support Record System (D049) to edit contractor requisitions by stock number. However, at the Warner-Robins ALC, this initiative had been implemented on only 3 of its 201 maintenance contracts, because the HO75C system currently cannot accept more than 66 data lines per contract and the contracts generally require more than 66 lines to list authorized GFM items. Furthermore, the computer data base needed to generate detailed stock number and quantity requirements for the D034A system continues to be inaccurate and incomplete. The Air Force is aware of the data line

limitations and data inaccuracies, but AFLC officials said that they do not expect to correct this situation until 1989.

- AFLC has authorized, on a test basis, the establishment of central organizations at each ALC to focus on GFM management problems. The new organization will specifically be responsible for the following tasks, which are currently not performed or are only partially performed:
  1. Analysis and justification for authorizing specific items of GFM for contractors.
  2. Update of HO75C edit data.
  3. Preparation of accurate and complete contract appendix B data to include authorized items and quantities.
  4. Audits and evaluations of contractor GFM stock levels.
  5. More real-time visibility and expedited disposition of excess GFM on hand at contractor facilities.

The test was completed in December 1987. In its comments on our draft report DOD said that AFLC has evaluated the test and is convinced that the centralized concept is a more efficient and productive way to manage the depot contract maintenance program.

- AFSC and AFLC will jointly develop a mechanized system to control production contractor requisitions. The target date for implementation (currently 1989) depends on improvements in the DO34A system.

## Weaknesses in Controls Over GFM After Issuance to Contractors

The FAR and contract provisions specify government and contractor responsibilities for establishing and maintaining control over material provided to contractors. Basically, contractors are to establish property control systems that are subject to review and approval by the military service and/or Defense Contract Administration Service (DCAS) property administrators. Once these systems are established, the property administrators maintain surveillance by conducting annual surveys of the property control system covering 10 categories or functional areas, ranging from acquisition, use, and consumption to recordkeeping and receiving. General guidance to property administrators for performing these annual surveys is given in supplement 3 to the FAR; additional guidance is provided by the services and DLA.



In past audits and congressional reports and hearings, DOD has been criticized for its inability to properly control and administer GFM provided to contractors. Our work, although limited, indicates that deficiencies in the government's oversight of contractors who are receiving GFM continue.

The following are examples of ineffective government oversight of GFM:

- Although the Air Force provides contract administrators with quarterly listings of GFM shipped to contractors to allow property administrators to independently verify the accuracy of contractor GFM receipt records, the listings were often not used, especially when property administrators were not permanently stationed at the contractor's plant. For example, property administrators in the Orlando Defense Contract Administration Services Management Area, which has surveillance responsibility for about 150 contractors throughout Florida, did not use the lists in their property surveys because they claimed they did not have sufficient time to do so. We found only one property administrator who used the GFM shipment lists.

The AFAA made similar observations in its 1987 report on GFM controls at contractor facilities. The Agency reported that at six Air Force Plant Representative Offices reviewed, none of the property administrators used the shipment lists. Instead they used contractor receiving documents to reconcile contractor GFM balances. The AFAA attributed this to Air Force Contract Management Division directives that did not incorporate the DODI 4140.48 procedures for independent verification.

- The DCAS property administrator at one contractor reported excess GFM estimated at \$4 million. However, contract officials at the Warner-Robins ALC did not provide instructions on how this excess GFM should be handled, as required by the FAR.
- At another contractor, the DCAS property administrator was not aware that between November 1985 and October 1986 the contractor had requisitioned about \$102,000 of GFM from 27 federal stock classes, which was not authorized in the contract. At the same contractor plant, the property administrator also did not routinely review GFM stock on hand to identify excess inventory, as required in the contract, because the contractor's GFM inventory status report to Warner-Robins lacked sufficiently detailed information on such things as item descriptions, part replacement rates, and item costs. Over \$360,000 of GFM was on hand, and a contractor official believed that most of it was excess to existing needs.

- At Eglin Air Force Base, neither the contracting officer nor the acting property administrator knew that a contractor did not maintain records for GFM items valued at \$50 or less and had not determined that this GFM was necessary to perform the contract. Subsequent to our field work, the contractor performed a physical inventory of all GFM in its possession and determined that the value of the inventory was \$4.4 million, of which about \$2.5 million (57 percent) was for items with a unit price of \$50 or less. Much of the \$4.4 million inventory may be in excess of needs. For example, from our random sample, 42 percent of 132 selected GFM items valued in excess of \$50 had not been used in 1-1/2 years and 33 percent had not been used in at least 3 years.

Further, only matters related to government-furnished equipment (e.g., plant and special test equipment) and none related to GFM had been addressed in the last three annual government property surveys at Eglin, and the individual acting as property administrator had not been officially assigned to that position.

- At Arnold Air Force Station, the Air Force had not done any property surveys of the base operations contractor since the contract award in October 1985. Also, the property administrator position was vacant from that time until the beginning of July 1987, when it was filled by the individual who had previously served as an alternate property administrator. During fiscal year 1986 the contractor obtained over \$1.6 million of GFM.
- One contractor had submitted 432 requisitions during a 1-year period with requisition priorities higher than authorized in the contract.<sup>4</sup> As a result, the government may have incurred higher than necessary personnel and transportation costs to fill and ship the requisitioned GFM. Another contractor also misapplied the government's requisition priorities. Between November 1985 and October 1986, the contractor submitted over 2,100 requisitions, over 94 percent at the highest priority designation authorized in the contract. However, some of these were for routine stock replenishment, and therefore the high priority designation was inappropriate. The DCAS property administrator did not detect this situation until recently. He asked the contractor to minimize the use of high priority requisition designators. The contractor agreed.

<sup>4</sup>Priority designators are assigned to requisition GFM on the basis of criticality of needs, ranging from work stoppage to routine stock replenishment. The priority of the requisition determines the priority placed on filling the requisition and the mode of transportation. According to a DLA audit report, the use of high priority designators often results in premium pay to personnel filling the requisition and in premium transportation costs.

- AFAA reported in 1986 that the ALCS purchased and shipped requisitioned GFM items on contracts that were completed or nearing completion. AFAA stated that, as a result of its review, 143 of 190 such orders valued at \$1.9 million were cancelled.<sup>5</sup>

## Financial Accountability and Controls

Since 1967, we as well as congressional committees have raised concerns relative to the financial accountability and controls for GFM at DOD contractors. DOD and the services were criticized for not having established independent controls to provide accountability over GFM from receipt by a contractor to use on a contract or return to DOD. In 1980, we recommended that DOD and the services establish accounting systems that adequately account for (1) the quantity and value of government material authorized and provided to contractors and (2) the receipt and use of this material by contractors.<sup>6</sup> We believed that information from such systems would give government property administrators independent data to enable them to judge whether contractor records, which are now the government's only accountable GFM records, conform to the FAR.

DOD concurred with our recommendations and, between 1981 and 1983, established general accounting principles and standards for GFM. However, the Air Force has not yet developed or implemented a GFM accounting system. As a result, the Air Force still does not have an independent means to identify how much GFM is in the hands of Air Force contractors, how much is being provided annually, how much is being used, and how much is in excess of needs. Contractors have all of this information; the Air Force has only partial information. For example, the AFAA reported that the Air Force provided an estimated \$11.5 billion of GFM to contractors during fiscal year 1985.<sup>7</sup> This estimate is probably understated since it does not include GFM provided to (1) service contractors at Air Force bases who are using Air Force unit DODAACS to obtain needed materials and (2) Air Force production and maintenance contracts administered by non-Air Force organizations, such as the Navy, Army, and DLA.

<sup>5</sup>Internal Controls Within Systems For Managing Material Furnished to Maintenance Contractors (Air Force Audit Agency, Report No. 6126113, Jan. 1986).

<sup>6</sup>Weaknesses in Accounting for Government Furnished Materials at Defense Contractors' Plant Lead to Excesses (FGMSD-80-67, Aug. 1980).

<sup>7</sup>Government-Furnished Material at Contractor Facilities (Air Force Audit Agency Report No. 6076410, Feb. 1987).

DOD and the Air Force have recently initiated actions to obtain better data on the amount of GFM on hand and being provided annually to contractors. Complete GFM data is expected to be available by the fall of 1989, although some information may be available earlier. However, this data will not include the value of GFM given to contractors that provide various services to Air Force bases.

## Financial Integrity Act Statements Do Not Identify Control Weaknesses

Air Force organizations prepare reports on internal control weaknesses as required by the Federal Managers Financial Integrity Act of 1982. These reports are consolidated at higher command levels, and eventually, Headquarters, U.S. Air Force, submits an annual consolidated Air Force-wide report to DOD addressing material weaknesses in internal controls.

We reviewed fiscal year 1986 reports submitted by Eglin AFB; Arnold Air Force Station; San Antonio, Oklahoma City, and Warner-Robins ALCS; AFLC Headquarters; and the Air Staff. Only the AFLC report addressed GFM internal control weaknesses related to contractor access. In its report, AFLC recognized the problem of verifying items and quantities on contractor requisitions. However, the report concluded that AFLC had complied with DODI 4140.48 and did not mention that the ALCS, contrary to AFLC regulations, continued to verify requisitions based on stock class rather than on specific items and quantities. In our view, this limited control represents a material weakness that should have been reported. The AFLC report also did not address the other control deficiencies discussed in this report.

In its comments on a draft of this report, DOD agreed that the fiscal year 1986 AFLC report did not identify the ALCS' noncompliance with the AFLC regulations and noted that this noncompliance was first surfaced by our report. DOD added that the actions the Air Force is taking or planning to take should address the internal control weaknesses we reported.

## Conclusions

DOD and the Air Force have had long-standing problems with accounting for and controlling GFM provided to contractors. Actions taken have not yet corrected the problems, and a number of significant internal control problems remain. For example, the Air Force cannot readily determine how much GFM is currently in the hands of contractors, how much the contractors receive annually, how much is used for authorized purposes, or how much is excess, because it has not yet implemented the necessary GFM accounting system. Further, there are continuing weaknesses

in controls before and after GFM is issued to contractors that make this area susceptible to fraud, waste, and abuse.

Control weaknesses pertaining to issuance of GFM have occurred for the following reasons:

- The Air Force has not adequately implemented an Air Force regulation that requires identification of specific parts and quantities needed to execute maintenance contracts and therefore is unable to determine whether unneeded GFM is being requisitioned.
- Contractors submit GFM requisitions that bypass established edits.
- Contractors have been allowed to use Air Force unit identification codes to obtain GFM instead of using codes that identify them as contractors.
- Air Force officials at the bases we reviewed did not thoroughly review base-level contractor requisitions to verify that the items and quantities requisitioned were needed to perform the contract.

Control weaknesses relating to GFM after issuance revolved around inadequate government oversight of contractor property control systems to ensure that the government's interests were adequately protected. For example, government property administrators (1) did not make use of GFM shipment lists to independently verify contractor GFM receipt records, (2) did not perform required annual property surveys, and (3) did not identify excess GFM inventories.

## Recommendations

We recommend that the Secretary of the Air Force direct that

- MCAs or their equivalents receive and validate all wholesale-level contractor requisitions before they are sent to the source of supply to be filled;
- AFLC improve the data base (D049) needed to generate stock numbers and quantities required for the Special Support Stock Control and Distribution System (D034A) to make it more accurate and complete;
- procedures similar to those performed by the MCAs at the wholesale level be adopted at the retail (base) level as soon as possible to review and validate all base-level contractor requisitions before they are sent to the source of supply;
- contracts providing for GFM at the retail level list the parts contractors are authorized to obtain whenever it is feasible to do so;
- all contractor requisitions be identified and assigned the required contractor DODAAC; and

- government property administrators conduct adequate annual surveys of the contractors' property control systems.

## Agency Comments

DOD agreed with all of our recommendations and advised us of actions already underway or planned to implement them. Regarding our recommendation that MCAs or their equivalents receive and validate all contractor requisitions before they are filled, DOD stated that the Air Force automated data routing system had been reprogrammed to prevent future contractor-initiated requisitions from bypassing established edits. Furthermore, the edits have been refined to ensure that the material requisitions are authorized.

On our recommendation to improve the data base that generates stock numbers and quantities required for the Special Support Stock Control and Distribution System, DOD stated that the Air Force had an ongoing effort to update and maintain an accurate and complete data base (D049-Master Material Support Record).

DOD agreed that all contractors, including those that support base service contracts, should be identified and assigned the required DODAAC. DOD stated that the Air Force had established new procedures in 1987 that would eliminate the assignment of military unit DODAACS to contractors. Full implementation is projected for 1989.

DOD agreed that procedures similar to those performed by MCAs at the wholesale level should be adopted at the retail level. After implementation of the new procedures on DODAACS in 1989, the Air Force expects the Administrative Contracting Officer and his functional area technical representatives to screen contractor material requisitions to ensure that there is a valid requirement for the material before actually providing it.

Regarding our recommendation that Air Force retail-level contracts authorizing GFM contain a listing of parts the contractors are authorized to obtain, the Air Force will direct that, when feasible, specific parts and quantities will be included in all base-service contracts.

Finally, DOD stated that the Air Force will reemphasize the importance of following established policy to conduct required annual surveys to determine the adequacy of contractor property control systems.



# Comments From the Deputy Assistant Secretary of Defense (Systems)



ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON D C 20301-8000

PRODUCTION AND  
LOGISTICS

(L/SD)

Mr. Frank C. Conahan  
Assistant Comptroller General  
National Security and International  
Affairs Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Conahan:


This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "INTERNAL CONTROLS: Air Force Controls Over Contractor Access To The DoD Supply System," Dated November 4, 1987 (GAO Code 391566) OSD Case 7458.

The Department agrees with the GAO draft report findings and recommendations. The in-depth review of the Air Force procedures conducted by the GAO will provide a useful complement to the actions already initiated within the Air Force and the Department of Defense to improve controls over Government-furnished material (GFM).

As indicated in the enclosed comments, the subject of contractor access to the supply system has been a subject of DoD concern for several years. New procedures for controlling contractor access have been written and, in several cases, implemented. Other procedures are currently being staffed within the Department for implementation over the next two years. The purpose of these new procedures is the resolution of the access and accountability problems noted in the GAO report.

The DoD appreciates the opportunity to provide its comments and the findings and recommendations of this draft GAO report.

Sincerely,

  
Jack Katzen  
Deputy Assistant Secretary of Defense  
(Systems)

Enclosure



**DEPARTMENT OF DEFENSE COMMENTS ON**

**GAO DRAFT REPORT-DATED NOVEMBER 4, 1987  
(GAO CODE 391566) OSD CASE 7458**

**"INTERNAL CONTROLS: AIR FORCE CONTROLS OVER  
CONTRACTOR ACCESS TO THE DOD SUPPLY SYSTEM CAN BE  
IMPROVED"**

\* \* \* \* \*

**FINDINGS**

- o **FINDING A: Air Force Compliance With Policy on Government Furnished Material (GFM).** The GAO reported it is Government policy that contractors provide the material necessary to accomplish their contracts, unless otherwise justified. The GAO pointed out that DoD regulations require exceptions to this basic policy be supported by sound rationale and documented in writing for future reference. The GAO reviewed selected service contracts at Arnold Air Force Station and at Eglin, Nellis and Patrick Air Force Bases and found that none of the locations had prepared any justifications. The GAO reported that contracting personnel stated it has been standard practice to provide all materials to base contractors free of charge. With regard to maintenance contracts, the GAO noted that, prior to 1984, Air Force regulations stated the DoD would normally provide, as GFM, parts available in the DoD supply system. The GAO pointed out, however, that in 1984, the regulations were revised to require maintenance contractors to provide readily available commercial material whenever possible. The GAO found, however, that, at the Air Force installations it visited, the contractors were still being provided extensive amounts of GFM. The GAO further found that the required detailed analyses and written justifications were not being prepared for most of the maintenance contracts. While acknowledging there may be valid reasons for providing GFM in some contracts, the GAO concluded that the Air Force has not adequately complied with procedures to analyze and justify each situation before providing GFM to contractors. (p. 2, pp. 20-25, pp. 27-28/GAO Draft Report)
- o **DOD RESPONSE:** Concur. The DoD policy is clear regarding the justification required prior to providing GFM to contractors. It is now a matter of compliance with established DoD policy by Air Force activities providing GFM

Enclosure

Now on pp. 3-4, 16-18, and 20.

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

to contractors. The Air Force Logistics Command (AFLC) has issued a supplement to Federal Acquisition Regulation (FAR)

45.102-91 that was implemented by letter on June 25, 1987. It requires the procurement contracting officer (PCO) and the system program manager (SPM) to certify the need for providing GFM to contractors and to place this certification in the contract file. Compliance and tracking will be accomplished during headquarters and Air Force Inspector General inspection visits. Additionally, the May 1987, Air Force Logistics Command Regulation (AFLCR) 66-8 ("Equipment Maintenance: Contract Maintenance Programs") is even more specific concerning justification documentation for providing GFM to maintenance contractors.

- o **FINDING B: Disadvantages of Providing GFM to Contractors.** The GAO acknowledged that there can be advantages to the Government in providing GFM to contractors. The GAO also identified several disadvantages. The GAO reported, for example, that contract provisions frequently require contractors to use GFM, whenever possible, even if materials are available commercially at a lower price. In addition, the GAO reported that since contractors face no financial risks and have no incentive to minimize GFM use, contractors may overorder and overstock Government materials. The GAO noted, in fact, that in some cases contractors may even have an incentive to order more parts than they need to preclude a possible parts shortage. A third disadvantage of GFM identified by the GAO is the effort and cost required to account for and control the material at contractor locations. The GAO reported that the Air Force monitors and controls GFM at contractor facilities and pays contractors to report data on GFM usage. The GAO pointed out, however, that an Air Force Audit Agency (AFAA) report found that the contractor GFM data is often inadequate. In addition, the GAO reported that the long-standing problem of controlling contractor access to the DoD supply system has not yet been solved. The GAO concluded that these disadvantages indicate the importance of adherence to the DoD policy and procedures covering GFM. (p. 2, pp. 25-28/GAO Draft Report)
- o **DOD RESPONSE:** Concur. The importance of adherence to DoD policy and procedures cannot be overemphasized, and the DoD agrees that there can be certain disadvantages to providing GFM to contractors. Accordingly, during AFLC certification of contracts, justification for GFM will be provided. As part of the solution to the problem of controlling GFM provided to contractors, on March 5, 1985, a change was implemented to edit GFM stock numbers and the quantity authorized. The quantity edit checks the requisitioned quantity against the authorized quantity. If the authorized quantity available is less than the quantity in the requisition, the requisition will reject. After

Now on pp. 3-4 and 19.

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

requisitions pass the national stock number (NSN) and quantity edits, the requisition is validated and passed to the source of supply for continued processing.

- o **FINDING C: Control Weaknesses: Edits Insufficient To Control Maintenance Contractor Requisitions.** The GAO found that, currently, the Air Force Logistics Command (AFLC) controls maintenance contractor requisitions by verifying that the requested items are within authorized stock classes. The GAO also found, however, that this practice enables maintenance contractors to have access to many parts not specifically needed to perform the contracts. The GAO noted that a 1986 AFAA report stated that of 180 requisitions reviewed, 33 were for items not required to repair the items in the contracts. According to the GAO, AFLC regulations required each Air Logistics Center (ALC) to list the specific GFM items or parts authorized in contracts and to screen requisitions under those contracts against the authorized listing. The GAO concluded that the current AFLC practice to control requisitions by stock class is not in compliance with AFLC regulations. The GAO noted that, according to ALC personnel, a specific problem in this regard has been, and continues to be, the inaccuracy of the end item parts lists. The GAO acknowledged that the AFLC has taken action to improve the accuracy of the lists. Based on its tests of the system, however, the GAO found that the lists continue to be inaccurate. The GAO concluded that the AFLC screening process is not sufficient to control contractor access to authorized GFM items. (pp. 1-2, pp. 29-30. pp. 34-37/GAO Draft Report)

- o **DOD RESPONSE:** Concur. The revision of AFLCR 66-8 (Appendix B and policy changes) will eliminate the use of Federal Supply Class (FSC) and Federal Supply Group (FSG) and state the GFM by NSN. This restriction will limit contractor requisitioning. The completed rewrite of Appendix B is tentatively scheduled for February 1988. The document is currently in the coordination process.

To verify the accuracy of the data in the Purchase Request Support List (PRSL) or the Material Requirements List (MRL), a review is made prior to release of the access authorization list to the contractor. In those instances where the PRSL or MRL contain errors, the document is returned to the certifying officer for corrections. There is an ongoing effort to update and improve system file maintenance and, consequently, the accuracy of these lists.

- o **FINDING D: Control Weaknesses: Computer Edit Deficiency.** The GAO found that, compounding the edit problem (also see Finding C), a computer edit deficiency existed at the Defense Automatic Addressing System Office that permitted contractors access to almost the entire DoD supply system.

Now on pp. 4-5, 21, 23-25,  
and 35.

**Appendix I**  
**Comments From the Deputy Assistant**  
**Secretary of Defense (Systems)**

According to the GAO, the problem involved a computer edit that would automatically change what it determined to be an incorrect stock class number to the correct number, and forward the requisition to be filled. The GAO reported that, between July 1986 and June 1987, over 345,000 automatic corrections were made, including nearly 42,000 that were Air Force related. The GAO pointed out, however, that many of these changes resulted in the shipping of incorrect items. The GAO noted that the automatic correction feature was discontinued as of September 1, 1987. The GAO concluded that this control weakness permitted contractors access to unauthorized items. (pp. 1-2, p. 34, pp. 37-38/GAO Draft Report)

Now on pp. 23-25.

- o **DOD RESPONSE:** Concur. The GAO was accurate in stating that the edit at the Defense Automatic Addressing System (DAAS) Office that validated the FSC by comparing it to the other half of the NSN, the National Item Identification Number (NIIN), introduced the possibility of incorrect items being shipped. The DAAS edit was not an error, however. It was an effective procedure used for many years to eliminate a large number of unnecessary rejections and redundant processing in the supply system. The process was initiated because there were a large number of the FSC changes being processed by the Federal Cataloging System during the period of time when the edit was in force. Frequently, notification of these FSC changes did not get distributed and posted at all locations in the supply system at the same time. The DAAS edit provided a service to the supply system to overcome the possibility of large numbers of rejections (for inaccurate NSNs) and subsequent corrections and re-requisitioning by replacing the former FSC with the updated FSC. The process correctly assumed that in the vast majority of cases the NIIN was correct and, therefore, was not the cause of the NSN inaccuracy. The number of FSC changes occurring in the supply system is much less frequent now than it was in the period when the edit was in force and the system ability to notify all involved activities of the FSC changes has improved significantly. For these reasons, the edit and the FSC correction at the DAAS were eliminated in an action totally unrelated to the GFM process. The elimination of the edit also removes the potential for contractor access to unauthorized items that was noted by the GAO.
- o **FINDING E: Control Weaknesses: Maximum Issue Quantities Not Controlled.** The GAO found that the Air Force management control activities (MCA) system, intended to establish automated internal control over contractor access to DoD material, has no checks to prevent a contractor from exceeding maximum quantities needed. The GAO also found that contractors can avoid edits designed to prevent Air Force units and contractors from depleting wholesale stock

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

levels. The GAO observed that the absence of effective controls over issue quantities contributes to excess material accumulating at contractor plants. The GAO noted, for example, that as of May 31, 1987, the Warner Robins ALC reported excess stock on 69 contracts totalling approximately \$9.1 million. The GAO noted that an official in the AFLC Directorate of Material and Production Support declined providing similar data for all ALCs because he considered the figures to be inaccurate. The official further stated that the actual excess may be higher or lower than the reported amounts, due to programming flaws in the excess reporting system. The GAO concluded that, although the Air Force does not know the amount of excess GFM on hand at contractor plants, it could be substantial. (pp. 38-40/GAO Draft Report)

Now on pp. 23-24 and 26.

- o **DOD RESPONSE:** Concur. The DoD acknowledges that this was a problem. Action has been taken to modify existing data systems to provide the necessary edits to control the availability of GFM to contractors.

A Stock Control and Distribution System revision (DO34A) was implemented March 6, 1987, to edit the requisitioned quantity against the contractual approval level. The Air Force now has more effective controls over issuance of GFM to contractors. As addressed in the DoD response to Finding B, the DO34A is currently programmed to reject requisitions if the requisitioned quantity is above the remaining authorized balance and to ship assets if the requisitioned quantity is under the remaining authorized balance.

The AFLC, Deputy Chief of Staff/Maintenance, computes and manages excess GFM on hand at contractor plants using actual data posted to General Ledger Account Codes. While there are known deficiencies in manipulation of this data that are currently being worked, the data products do reflect the level of GFM at a given time. Also, a change to improve the accuracy of computation of excess GFM is in process, with a scheduled implementation date of April 30, 1988. This GFM data is analyzed monthly and necessary actions are directed to the field. Excess computations are also reported using a methodology which was completely changed in June 1987, and is currently being further refined to provide an accurate position of excess GFM.

- o **FINDING F: Control Weaknesses: Contractors Bypass Established Edits.** The GAO explained that bypasses occur when a maintenance contractor omits specific required coding in its GFM requisition, allowing it to go directly to the source of supply for needed parts or when Air Force assigns military unit activity address codes to contractors. The GAO reported that the AFAA found instances where Air Force maintenance contractors bypassed all computer system edits,

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

sending the contract requisition directly to the source of supply for needed parts. The GAO also found numerous instances of contractor requisitions bypassing edits, but noted that it could not determine the frequency of such actions or the total value of the GFM obtained in this way. The GAO also found that, in violation of standard DoD military requisitioning and issue procedures, the Air Force has assigned military unit DoD Activity Address Codes to at least 21 major contractors. The GAO observed that, by doing this, contractor GFM requisitions are treated in the same manner as Air Force unit requisitions and, as such, bypass all edits specifically established to control contractor requisitions. According to the GAO, Air Force officials explained that the Address Codes were assigned to streamline the requisition process. The GAO noted that Air Force officials cited a case where the use of the contractor Address Code resulted in the cancellation of numerous legitimate GFM requisitions; the Air Force solution was to provide the contractor with a military address code instead of a contractor address code. The GAO found, however, that the real problem was that the Air Force Station did not provide copies of contract documents authorizing GFM requisitions to the appropriate Air Force ALCs and the contract did not specify what GFM the contractor was authorized to obtain. The GAO concluded that deficiencies in internal controls allowed contractor requisitions to bypass established edits. (pp. 40-42/GAO Draft Report)

Now on pp. 4, 21, 23-24,  
26-28, and 35.

o **DOD RESPONSE:** Concur.

The Air Force automated data routing system (M024) was programmed to pass selected contractor-initiated requisitions directly to the Item Manager-Stock Control and Distribution System (D032) for immediate shipment, without going through an Air Force Management Control Activity (MCA) review. When the M024 program was implemented, it contained an approved special projects table that exempted nine contractors from the D034A edits and subsequent MCA reviews. On July 15, 1987, however, the M024 system was reprogrammed to prevent those selected contractor-initiated requisitions from bypassing the D034A edits. The system change is now working as intended and no longer passes requisitions directly to the source of supply.

In July 1986, the Defense Logistics Standard Systems Office (DLSSO) requested the DAAS to perform edits on GFM transactions flowing through the DAAS. The requested edits were implemented by the DAAS on September 8, 1986. All GFM transactions processed by the DAAS will be required to comply with the provisions of the Military Standard Requisitioning and Issue Procedures (MILSTRIP). Those GFM transactions not passing the edit will be rejected to the initiator.

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

Those contractors that support Base O&M service contracts will be assigned a contractor DoD Activity Address Code of "EX"-series codes upon implementation. In March 1987, a change was written to establish the "EX" Stock Record Account Number (SRAN). The change underwent final review at the configuration review board meeting on December 10, 1987. Implementation will occur after the Stock Control and Distribution (SC&D) system is fully operational in 1989. The system implementation change will eliminate the assignment of military unit DoD Activity Address Codes. The validation of "EX" contractor requisitions will be accomplished by the Administrative Contract Officer prior to submission to the source of supply. Upon system implementation, the Air Force will have three categories of contractor activity address codes: "EY" production, "EZ" maintenance, and "EX" service contractors.

- o **FINDING G: Control Weaknesses: GFM Authorizations Modified Without Formal Approval.** The GAO noted that, according to the Federal Acquisitions Regulations (FAR), contracting officers are to approve, in writing, any modification to the original contract. The GAO found, however, that at least two contracts at the Warner Robins ALC were being modified without formal approval. The GAO reported that during the period of November 1, 1985 to October 31, 1986, these contractors obtained about \$102,000 and \$620,000, respectively, of material not specifically authorized by their contracts. While acknowledging that the parts from the additional stock classes were needed to support the contracts and that the action of the contracting staff expedited the GFM requisitioning process, the GAO noted that Warner Robins contracting officials agreed that the contracting officer should have been notified and that contracts should have been modified to reflect the authorization of the additional stock classes. The GAO further noted that the Air Force officials stated that the current practice would be discontinued immediately. The GAO concluded that such practices are indicative of Air Force control weaknesses over GFM. (pp. 43-44/GAO Draft Report)
- o **DOD RESPONSE:** Concur. In November 1986, the Under Secretary of Defense (Acquisition) issued a memorandum, to increase emphasis on controlling GFM provided to contractors. In response, the AFLC issued a supplement to FAR Supplement 45.102-91 on June 25, 1987, requiring that the Procurement Contracting Officer (PCO) and System Program Manager (SPM) certify the need for providing any GFM to contractors and place this certification in the contract file. This memorandum covers any type of GFM required for any type of contract.
- o **FINDING H: Control Weaknesses: All Contractor Requisitions Not Verified.** According to the GAO, the ALC Material

Now on pp. 23-24 and 28.

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

Utilization Control Offices (MUCOs) serve as the management control activities for research and development contracts. The GAO pointed out, however, that a 1987 AFAA report found that the MUCOs were not verifying all contractor requisitions to ensure they were contractually authorized and approved prior to shipment. The GAO noted that this occurred because the MUCOs did not have copies of the authorized GFM material lists in the contracts. According to the GAO, the AFAA reported that, out of a sample of 144 contractor requisitions (valued at \$6 million), 90 requisitions (valued at \$2.7 million) were not verified. The GAO concluded that not verifying contractor requisitions prior to approval is another GFM control weakness. (p. 44/GAO Draft Report)

Now on pp. 23-24 and 28.

- o **DOD RESPONSE:** Concur. As the result of the AFAA audit, an AFLC letter was sent to the Air Logistics Centers (ALCs) on May 28, 1987, to reiterate the the need for strict compliance with existing AFM 67-1 (Air Force Supply Manual) policy and the need to stress the release of only those items on the GFM master list for each contract. Enforcement will be through review by the AFLC Inspector General. Also, the AFLC and the Air Force Systems Command (AFSC) are working jointly to implement a document system for assuring that the MCAs receive and retain all required contract authorization documentation for GFM. The AFLC will contact the AFSC by December 31, 1987, proposing an early 1988 meeting. This issue will receive close scrutiny by Air Force headquarters to ensure that satisfactory progress is made.
- o **FINDING I: Control Weaknesses: Base-level Contractor Requisitions Not Reviewed.** The GAO reported that, generally, retail level base contractors depend on base supply offices to stock materials with which to support their contracts. The GAO found that, at Eglin Air Force Base and Arnold Air Force Station, base supply clerks reviewed the requisitions for administrative accuracy, but no one reviewed them to verify that the items and quantities ordered were necessary to perform the contracts. The GAO further found that the total amount of GFM obtained by base contractors can be substantial. The GAO noted that one reason for the lack of review of GFM requisitions appears to be the lack of specificity on base contracts. The GAO concluded that failure to review thoroughly base-level contractor requisitions for the purpose of verifying that the items are actually needed to perform the contract is another control weakness. (pp. 44-45/GAO Draft Report)
- o **DOD RESPONSE:** Concur. The Air Force has initiated actions to examine thoroughly all aspects of the issue of retail level contractor access to the supply system. A FY 1989 Air Force Audit Issue has been proposed to conduct a review of

Now on pp. 21, 29, and 35.



**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

all aspects of the issue of control of Government property and a FY 1990 inspection of all Major Air Commands will involve a detailed evaluation of all procedures controlling access to the DoD supply system. Pending the outcome of these reviews, the Air Force will use the following process to monitor access to the supply system by retail level contractors.

- The AFLC's property administrators (PAs), through their surveillance of base contractors, review the requests for GFM.
  - As part of the PA annual surveillance, requisitions/purchase orders are reconciled for that period and any problems are reported to the Administrative Contracting Officer (ACO).
  - The ACO and his/her functional area technical representatives screen contractor requisitions to validate requirements in terms of the technical necessity of the requisitioned items to support the contract.
- o **FINDING J: Air Force Actions to Correct Internal Control Problems.** According to the GAO, AFLC officials recognized that effective internal controls over GFM provided to their contractors have not been achieved, but noted that several corrective actions are underway. The GAO reported that, in March 1985, the AFLC programmed the Special Support Stock Control and Distribution System and the Accounting System for Industrial Fund Procurements for GFM to edit contractor requisitions by stock number. The GAO found, however, that at the Warner Robins ALC, this initiative had been implemented on only three of its 201 maintenance contracts, because the Accounting System currently cannot accept enough data lines to list authorized GFM items. The GAO further noted that the computer data base needed to generate detailed stock number and quantity requirements continues to be inaccurate and incomplete. The GAO reported that a second corrective action identified by the AFLC was its authorization, on a test basis, to establish central organizations at each ALC to focus on GFM management problems. The GAO also reported that the AFSC and the AFLC will jointly develop a mechanized system to control production contractor requisitions. The GAO concluded, however, that the actions taken have not yet corrected the GFM problems, and a number of significant internal control problems remain. (pp. 45-47, p. 55/GAO Draft Report)
- o **DoD Position:** Concur. It should be recognized, however, that the HO-75C was never intended to edit contractor requisitions by the NSN. One purpose of the HO-75C was to provide contracting data to the D034A system such as

Now on pp. 21, 29-30, and 34.

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

contract number, contract SRAN, abbreviated contract number, etc., after the contract is established. The DO34A and the Master Material Support Record (DO49) were programmed to edit by the NSN. It is true that only three of the 201 maintenance contracts were edited by the NSN. However, this is largely because, after March 1985, the AFLC did not annotate all existing contracts with the NSN data necessary to administer them in accordance with the revised process.

It is acknowledged that the data base for detailed NSN and quantity edits was inaccurate. As noted in the DoD response to Finding C, however, there is an ongoing effort to update and improve system file maintenance and, consequently, the accuracy of the Purchase Request Support List (PRSL) and the Material Requirements List (MRL) lists, which are used to identify the NSNs that are to be authorized as GFM in individual contracts.

In an effort to improve the management of GFM, the AFLC established, on a one year test basis, centralized seller organizations in various forms at the ALCs. The AFLC evaluated the one year test and is convinced that the centralized concept is a more efficient and productive way to manage the depot contract maintenance program.

Finally, actions are underway between the AFLC and the AFSC to develop a mechanized system to control production contract requisitions [see the DoD response to Finding H]. The Air Force will continue to monitor the progress of actions between AFLC and AFSC to solve this problem.

- o **FINDING K: Weaknesses In Controls Over GFM After Issuance to Contractors.** The GAO reported that in past audits and congressional reports and hearings, the DoD has been criticized for its inability to properly control and administer GFM provided to contractors. While acknowledging that its work was limited, the GAO found that deficiencies are continuing in the Government surveillance of those contractors receiving GFM. As an example, the GAO cited that at Hayes International Corp., the DCAS property administrator reported excess GFM estimated at \$4 million. The GAO found, however, that contract officials at the Warner Robins ALC did not provide instructions on how this excess GFM should be handled, as required by the FAR. As another example, the GAO reported that at Eglin Air Force Base, neither the contracting officer nor the acting property administrator knew that one contractor did not maintain records for GFM items valued at \$50 or less, and had not determined that this GFM was necessary to perform the contract. As still another example, the GAO noted that, in 1986, the AFAA reported the ALCs purchased and shipped requisitioned GFM items for contracts that were completed or nearing completion. (The AFAA reported that as a result of

Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)

Now on pp. 3-5, 21, 30-33,  
and 35.

its review, 143 of 190 such orders, valued at \$1.9 million, were cancelled.) The GAO concluded that control weaknesses relating to GFM after issuance revolve around inadequate Government surveillance of contractor property control systems to ensure that the Government interests are adequately protected. (pp. 47-52, p. 56/GAO Draft Report)

- o **DOD RESPONSE:** Concur. The AFLC recently reemphasized to its field activities the importance of following the Federal Acquisitions Regulations (FAR) 45.6 policies and procedures for disposition of GFM excess to contract requirements. To address the deficiencies identified in the AFAA report, the D034A system is being programmed to: (1) generate a product to identify all back-orders applicable to completed contracts and (2) include in this product those contracts within 60 days of completion, if contract extension does not occur. Also, contract administrators are placing increased emphasis upon surveillance of contractor's performance regarding control of GFM assets. A new program will be implemented on December 31, 1987, to identify those contracts due to expire in 60 days.
- o **FINDING L: Financial Accountability and Controls.** The GAO noted that, since 1967, the GAO, as well as congressional committees, have raised concerns relative to the financial accountability and controls for GFM at DoD contractors. The GAO noted that, in 1980, it recommended that the DoD and the Services establish accounting systems that adequately account for (1) the quantity and value of government material authorized and provided to contractors, and (2) the receipt and use of this material by contractors. According to the GAO, the DoD concurred with its recommendations, and between 1981 and 1983, the DoD established general accounting principles and standards for GFM. The GAO found, however, that the Air Force has not yet developed nor implemented a GFM accounting system. The GAO concluded that, as a result, the Air Force still does not have an independent means to identify how much GFM is in the hands of Air Force contractors, how much is being provided annually, how much is being used, and how much is in excess of needs. The GAO observed that only partial information is available to the Air Force. The GAO acknowledged that the DoD and the Air Force have recently initiated actions to obtain better data on the amount of GFM on-hand and being provided annually to contractors. The GAO concluded, however, that this data will still not be sufficient to identify the value of the GFM given to contractors who provide various services to Air Force bases. (pp. 52-53/GAO Draft Report)
- o **DOD RESPONSE:** Concur. Effective October 1, 1987, the Air Force financial reporting to the DoD and the Treasury includes the value of both maintenance and production GFM

Now on pp. 3, 5, 21,  
and 33-34.

Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)

held by contractors. Also, GFM expense data are collected and reported for the value of GFM given to contractors that provide various services to Air Force bases. The GFM issued to contractors providing base services is expensed upon issue; the same as is done for consumable items issued to Air Force organizations. Operations and maintenance appropriations are charged through the Air Force General Accounting and Finance System. This system provides an annual summary of GFM provided by Air Force bases to contractors.

- o **FINDING M: Financial Integrity Act Statements Do Not Identify Control Weaknesses.** The GAO found that, of the FY 1986 reports submitted by the Air Force components it reviewed, only the AFLC report addressed GFM internal control weaknesses related to contractor access. The GAO further found that, although the AFLC report recognized the problem of verifying items and quantities on contractor requisitions, the report concluded that the AFLC is in compliance with DoD Instruction 4140.48. The GAO pointed out, however, that the report did not mention that the ALCs, contrary to AFLC regulations, continue to verify requisitions based on stock class, rather than specific items and quantities. The GAO concluded that this limited control represents a material weakness that should have been reported. The GAO observed that the AFLC report did not address the other control deficiencies it identified. (p. 54/GAO Draft Report)
- o **DOD RESPONSE:** Concur. The ALC noncompliance with the AFLC regulations was not included in the AFLC FY 1986 report, due to the AFLC not having evidence of such noncompliance. This noncompliance was first brought to the attention of the Department by this GAO report. The actions identified in the DoD positions on several of the earlier findings also address this issue, particularly the responses to Finding B and Finding E regarding the institution of the edit on the NSN and quantity. The issuance of the Approved MILSTRIP Change Number 1 on January 8, 1988 will specify revised detailed procedures on processing contractor requisitions for GFM, as well as the process of compliance with the DoD Instruction 4140.48. The Air Force (and the other Military Services and Agencies) will be asked to provide implementation dates for the revised MILSTRIP procedure in the 1988-1989 time period.

**RECOMMENDATIONS**

- o **RECOMMENDATION 1:** The GAO recommended that the Secretary of the Air Force direct all Air Force commands and activities to enforce compliance with existing Federal Acquisition Regulations and DoD and Air Force policies regarding GFM

Now on pp. 21 and 34.

**Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)**

Now on pp. 5 and 20.

that, among other things, require decisions to allow contractors to obtain GFM are justified in advance, in writing, and are adequately documented to demonstrate that they are in the best interest of the Government from a cost-effectiveness or other critical standpoint. (pp. 2-3, p. 28/GAO Draft Report)

- o **DOD RESPONSE:** Concur. The DoD agrees that additional documentation and justification are necessary. As stated in the DoD response to finding A, the DoD policy is clear on this matter and it is now a compliance issue. The DoD will ensure that additional emphasis is placed by management staffs at all levels within the Air Force to ensure that this policy is strictly adhered to for all contracts where GFM is provided (maintenance, production, and base services contracts).

Now on pp. 5 and 35.

- o **RECOMMENDATION 2:** The GAO recommended that the Secretary of the Air Force direct that management control activities or their equivalents receive and validate all wholesale level contractor requisitions before they are sent to the source of supply to be filled. (p. 3, p. 56/GAO Draft Report)

- o **DOD RESPONSE:** Concur. As discussed in the DoD responses to Findings B, E, and F, the M024 AUTODIN routing system was reprogrammed on 15 July 1987, to prevent contractor requisitions from bypassing D034A edits. These edits were devised to ensure that contractors received only items they are authorized. Refinements have been made to the system to edit requisitions by stock number and quantity authorized.

Now on pp. 5 and 35.

- o **RECOMMENDATION 3:** The GAO recommended that the Secretary of the Air Force direct that the AFLC improve the accuracy and completeness of the data base needed to generate stock numbers and quantities required for the Special Support Stock Control and Distribution System. (p. 56/GAO Draft Report)

- o **DOD RESPONSE:** Concur. The D049 Master Material Support Record (MMSR) is the data base that generates stock numbers and quantities required for the Special Support Stock Control and Distribution System. The D049 is a breakdown of all active or potentially active weapon systems and depot recoverable end items in the Air Force inventory. The breakdown includes a complete range of parts and special tools and test equipment required for depot repair. A replacement percent of component items is computed in the system based on actual or predicted usage during repair. The usage is reported to D049 from various systems. Data are reviewed for accuracy prior to releasing to the contractor. There is an ongoing effort to update and keep the D049 system file maintained.

Appendix I  
Comments From the Deputy Assistant  
Secretary of Defense (Systems)

Now on pp. 5 and 35.

- o **RECOMMENDATION 4:** The GAO recommended that, as soon as possible, the Secretary of the Air Force direct that procedures similar to those performed by the management control activities at the wholesale level be adopted at the retail (base) level to review and validate all base-level contractor requisitions before they are sent to the source of supply. (p. 56/GAO Draft Report)
- o **DOD RESPONSE:** Concur. Upon implementation of "EX" series accounts, improved control over centrally procured equipment will exist, and screening of contractor requisitions by the Administrative Contracting Officer (ACO) and his/her functional area technical representatives prior to requisitioning will ensure validation of contractor requirements. Necessary steps will be taken to implement contract provisions and document flow procedures to ensure that contractor access to the supply system is controlled. (Also see the DoD response to Finding F.)

Now on pp. 5 and 35.

- o **RECOMMENDATION 5:** The GAO recommended that, whenever it is feasible to do so, the Secretary of the Air Force direct that contracts at the retail level providing for GFM contain a listing of parts contractors are authorized to obtain. (p. 57/GAO Draft Report)
- o **DOD RESPONSE:** Concur. Whenever it is feasible to do so, base level contracts should specify NSNs of the specific items of government property the contractor is authorized to obtain. Within the next 60 days, the Air Force will issue direction that, whenever feasible, specific NSNs and quantities will be included in all base service contracts.

Now on pp. 5 and 36.

- o **RECOMMENDATION 6:** The GAO recommended that the Secretary of the Air Force direct that Government property administrators conduct adequate annual surveys of the contractor property control systems. (p. 3, p. 57/GAO Draft Report)
- o **DOD RESPONSE:** Concur. This recommendation again involves compliance with established DoD policy. The Defense Acquisition Regulation includes as one of the duties of property administrators and ACOs, the responsibility to perform an annual survey of contractor performance. Continued emphasis by management headquarters is required to ensure compliance with established policy. Within the next 60 days, the Air Force will issue direction reemphasizing the importance of compliance with established DoD policy concerning annual surveys of contractor performance.

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