

May 1988

GOVERNMENT
PROPERTY

DOD's Management of
the Property It
Furnishes to
Contractors



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

National Security and
International Affairs Division

B-222859

May 26, 1988

The Honorable Frank C. Carlucci
The Secretary of Defense

Dear Mr. Secretary:

On March 21, 1988, we testified on Department of Defense (DOD) management of government property furnished to Defense contractors before the Senate Committee on Governmental Affairs. Our testimony focused on three areas: (1) the effectiveness of DOD's implementation of the basic government policy of relying on contractors to provide the property needed for government contracts, (2) the adequacy of management controls established to validate and approve contractor requisitions, and (3) the adequacy of government oversight over property in the possession of contractors. A copy of our testimony is included as an appendix.

Government property provided to contractors includes both material and equipment. Material includes parts, components, assemblies, raw materials, and supplies that (1) may be incorporated or attached onto such products as tanks and ships or (2) may be expended or consumed in performing a contract, such as office supplies. Equipment includes plant and special test equipment.

In 1986, we reported to you that DOD had not adequately implemented a program established in the early 1970s that was designed to phase down government-furnished equipment in the possession of contractors.¹ Also in 1986, we reported to the Chairman, Senate Committee on Armed Services' Task Force on DOD Inventory Management, that DOD had a wide range of inventory management problems throughout the supply system.²

As a result of that report, the Task Force and the Senate Committee on Governmental Affairs asked us to identify the magnitude of these problems and examine several aspects in more detail. One of the areas we were asked to specifically address involved the adequacy of management controls over contractors obtaining material from the government.

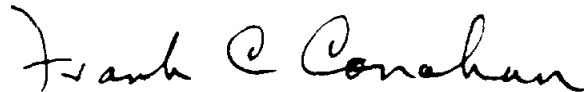
¹Government Equipment: Defense Should Further Reduce the Amount It Furnishes To Contractors (GAO/NSIAD-86-109, June 19, 1986).

²Inventory Management: Problems in Accountability and Security of DOD Supply Inventories (GAO/NSIAD-86-106BR, May 23, 1986).

the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen, House and Senate Committees on Appropriations and Armed Services, House Committee on Government Operations, and Senate Committee on Governmental Affairs; the Director, Office of Management and Budget; and other interested parties.

Sincerely yours,

A handwritten signature in cursive script that reads "Frank C. Conahan".

Frank C. Conahan
Assistant Comptroller General

Contents

Abbreviations

ASPR	Armed Services Procurement Regulations
CAM	Contractor-Acquired Material
DAR	Defense Acquisition Regulations
DLA	Defense Logistics Agency
DOD	Department of Defense
DODAAC	Department of Defense Activity Address Code
FAR	Federal Acquisition Regulation
GFE	Government-Furnished Equipment
GFM	Government-Furnished Material
IG	Inspector General
MCA	Management Control Activity
NAVPRO	Naval Plant Representative Office
NAVSEA	Naval Sea Systems Command
SUBASE	Naval Submarine Base
SUPSHIP	Supervisor of Shipbuilding, Conversion, and Repair

require that contractors account for and safeguard government property in their possession. Fourth, DOD and the services have not yet implemented financial accounting systems that would give them independent data for judging whether contractors' records are accurate. In our opinion, these factors need to be adequately addressed to ensure that the potential for fraud, waste, and abuse is minimized, maximum benefits accrue to the government, and the government's sizeable investment in property is safeguarded and protected.

DOD has taken a series of steps to correct some of the deficiencies that we have reported on over the last 20 years. However, overall corrective actions have been slow and focused primarily on modifying existing policies rather than implementation and enforcement.

Our testimony, which will also identify and discuss DOD and service actions to alleviate known problems, will focus on one category of government property—government material—furnished for the performance of maintenance and service contracts. We will also briefly discuss our past efforts on DOD's management of government-furnished equipment (GFE), which for purposes of this testimony, we define as industrial plant equipment, other plant equipment, and special test equipment.

Background

GFE includes industrial plant equipment, other plant equipment, and special test equipment used or capable of being used in the manufacture of products or performance of services. Government-furnished material includes parts, components, assemblies, raw and processed materials, and supplies that (1) may be incorporated or attached onto final products, such as aircraft, tanks, and ships, or (2) may be expended or consumed in performing a contract, such as office supplies.

DOD's 1986 report on property showed the following amounts of government material and GFE as of September 30, 1986.

Table 1.1: Reported Amount of Government Material and Equipment Furnished to Defense Contractors

Figures in billions			
Defense component	Government material	Government equipment	Total
Army	\$2.4	\$3.4	\$5.8
Navy	7.7	2.7	10.4
Air Force	6.0	4.1	10.1
Other	—	0.1	0.1
Total	\$16.1	\$10.3	\$26.4

systems are subject to review and approval by DOD property administrators. To do this, property administrators are to perform annual surveys of the systems. The surveys are divided into 10 categories ranging from property acquisition, use, and consumption to receiving and record-keeping. Deficiencies noted during these surveys are to be reported to the contractor for prompt corrective action. If the contractor fails to establish and maintain an effective property control system, the government can disapprove the system, and the contractor can be held liable for future losses or damage to government property.

Further, the government's policy is to rely almost entirely on the contractor's property control records. The FAR designates the contractor's books as the official records. According to the FAR, these official records must identify all government property and provide a complete, current, and auditable record of all transactions. Generally, defense agencies do not maintain independent records of property after it has been provided to contractors.

Government-Furnished Material: Need for Better Management Controls, Oversight, and Accountability

Since 1967, GAO and Defense internal audit organizations have issued numerous reports on the management, use, and accountability of GFM (see app. II). These reports contain many examples of deficiencies and abuses of established government and DOD policies and procedures. Major systemic deficiencies include: (1) the basic government policy of relying on contractors to provide material needed for government contracts has not been effectively implemented; (2) government oversight of defense contractor property control systems has been inadequate; (3) contractor handling of GFM is in need of improvement; and (4) DOD has not had financial accountability over GFM.

Our review of the reports, coupled with the results of our recently completed work at selected service commands, installations, and contractors showed a continuation of the previously reported systemic deficiencies. A summary of our major findings follows.

Lack of Compliance With Government Policy on Providing Material

When it is in the best interest of the government, DOD can provide material to contractors. It might be appropriate, for example, for the government to provide an item that is military-unique or not readily available from commercial sources.

the DOD supply system. For example:

- One Air Force contractor was authorized to buy 18 air compressor doors commercially because they were not in stock in the DOD supply system. He obtained the doors for \$21 each commercially, whereas the DOD catalog price was \$253.
- Another Air Force contractor obtained numerous electronic components commercially at a price less than half of the DOD catalog price. He was required by his contract to identify the most economical source and then 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 from commercial sources.

DOD concurred with our findings and stated that its policy regarding the need for justification prior to providing GFM to contractors is clear. DOD stated that the problem was essentially one of compliance and that steps would be taken to ensure better compliance through monitoring and testing by Air Force headquarters and its Inspector General.

Inadequate Controls Over the Issuance of GFM to Contractors

In response to the reports of numerous abuses of DOD policies shown in appendix II and various congressional reports resulting from hearings on this subject (see app. III), DOD issued an instruction (DODI 4140.48) in March 1981. This instruction required the services to establish one or more management control activities (MCA) to maintain central control over maintenance contractors' access to the DOD supply system by reviewing, validating, and approving contractor requests for GFM. DOD expected implementation of this instruction by November 1982. In March 1986 DOD issued a revised instruction that expanded the scope to all types of contracts, including both base and centrally awarded service, production, and research and development contracts. However, the instructions have either lacked full implementation by the services or implementation procedures and practices have been ineffective. For example, with respect to maintenance contractors:

- The Army has not yet implemented MCA controls as envisioned by DOD because it has not completed development of an automated system it believes is needed to effectively implement such controls. According to Army officials, contributing factors that slowed MCA implementation

were determined by the Air Force Audit Agency to be improper and were referred to the Air Force Office of Special Investigations for further assessment.

- GFM authorizations were modified by Air Logistics Center staff without the necessary approval from the contracting officer as required by the FAR. We identified two contracts at one Air Logistics Center that were improperly modified. As a result, two contractors received about \$722,000 of GFM that they were not authorized to obtain by their contracts. Center officials agreed that the contracting official should have been notified and stated that the current practices would be discontinued immediately.

We found that all of the services have taken or are taking some action to implement the revised instruction on nonmaintenance contracts awarded either centrally or at the base (retail) level. However, none of them has developed a definite plan of action or a target date for full implementation.

Weaknesses in Controls Over Material After Issuance to Contractors

As previously mentioned, the FAR and contract provisions specify government and contractor responsibilities for establishing and maintaining control over material provided to contractors.

Our work and recent Defense audits disclosed weaknesses in both contractor controls and government oversight over GFM. These conditions have contributed, in some cases, to the accumulation of excess material.

The following are examples of contractor property control weaknesses and ineffective government oversight of GFM.

- One Navy contractor had accumulated potential excess material valued at \$7.1 million under one contract. The government's property surveys for 1982 through 1986 disclosed that the contractor (1) had no written procedures for conducting physical inventories, (2) had not taken annual GFM inventories, (3) was not adequately monitoring GFM under the control of subcontractors, (4) did not report all instances of GFM losses and damage, (5) had lost material when transferring between locations, and (6) had recorded property balances that differed significantly from the property administrator's physical inventory. In December 1986 the contracting officer threatened the contractor with disapproval of his property control system. Navy and contractor officials agreed that there was potential excess GFM. They are now determining the exact amount of excess material and what to do with it.

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. 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.

- The Air Force Air Logistics Centers provide contract administrators with quarterly listings of GFM shipped to contractors to allow property administrators to independently verify the accuracy of contractor GFM receipt records. However, 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 Air Force Audit Agency made similar observations in its 1987 report on GFM controls at contractor facilities. The Agency reported that from 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 Agency attributed this to Air Force Contract Management Division directives that did not incorporate the March 1981 and 1986 DODI 4140.48 procedures for independent verification.

During our review we found several instances indicating that the property administration area, especially at military installations, suffered from personnel shortages. For example, the Naval Regional Contract Center, Long Beach, California, which awards all types of contracts for the western part of the United States, had no property administrator and needed to rely on military installations to provide property administration services. Of the 120 military installations the Center served, only one had a property administrator.

DOD has recognized that over the years the property administration function has been given a relatively low priority for personnel resources. In 1986 DOD directed the services to realign existing resources to provide for adequate staffing.

Service could not account for an additional \$900 million of government property recorded in the contractor's property system.

We are also concerned that the DOD property report does not contain data dealing with the amount of government material added (acquired) and deleted (used, returned, or disposed of) during each fiscal year. The amount of material added and deleted is in the billions. For example, one Army contractor had obtained an estimated \$236 million of government property during fiscal year 1986. On a broader scale, the Air Force Audit Agency reported in 1987 that the Air Force provided an estimated \$11.5 billion of GFM during fiscal year 1985 to contractors.

Information on the value of additions and deletions is desirable for several reasons. One reason is to let managers at various levels know the amounts of material that have been provided, used, or disposed of under each contract, for each command, or for each service. Second, the information can be used to identify contracts with potential excess material by relating on-hand balances to additions or deletions. Third, it would provide information on material provided on contracts where work has been completed.

DOD officials informed us that they decided not to include the additions and deletions because they believed the collection of such data would not be cost-effective.

Government-Furnished Equipment: Management and Control Problems Continue but Improvement Actions Are Underway

The management and control of GFE was identified as a problem more than 2 decades ago, and numerous reports have been issued by DOD audit agencies and us since then on this subject. These reports basically have identified recurring problems in the management, control, and use of GFE.

Our most recent work in the GFE area resulted in a June 1986 report to the Secretary of Defense entitled Government Equipment: Defense Should Further Reduce the Amount it Furnishes to Contractors. This report advised the Secretary that management oversight problems reported on in the past had remained essentially unchanged and that little progress had been made by DOD in implementing overall government policies that call for minimizing the amount of equipment the government furnishes to contractors. More specifically, the report pointed out that several major factors had impeded progress, including

discarded. In support of this office, each service secretary should designate a focal point responsible for the overall management of government-furnished property within the service.

DOD and Service Initiatives

In response to DOD and our past report recommendations on government property, the Undersecretary of Defense for Acquisition issued a property policy memorandum in November 1986. This document provides guidance to the services for improving the management of all government property in the possession of contractors. For example, the services were directed to (1) reduce the amount of government property provided to contractors, (2) improve property accountability records, (3) establish standard financial accounting systems, and (4) determine and recover any improper profit or fees paid to contractors for acquiring equipment under facilities contracts. DOD expected aggressive implementation of this policy to take place in order to show positive results.

In addition to advising the Congress of this "new" policy in January 1987, DOD officials briefed your Committee staff on February 18, 1988, on the policy and provided some data on actions taken. The DOD Inspector General and the Defense Council on Integrity and Management Improvement are tracking progress. We believe that the initiatives address the major property issues raised over the years and, if properly implemented, should have a positive impact on the government's ability to minimize the potential for fraud, waste, and abuse of government property.

The services have also initiated a number of actions to improve their management and control of government property. For example, the Army has made a number of changes to existing DODAAC procedures, such as limiting the shipment of GFM to only authorized addresses to reduce opportunities for fraud, waste, and abuse. The Navy has prepared a draft instruction that will standardize existing GFM requisition review and approval procedures for all contracts. The Air Force programmed their automated supply systems to edit contractor requisitions for material by stock number rather than by stock class, thereby improving internal controls over the GFM requisitioning process.

Most of the service actions appear to be oriented toward refining existing policies and procedures. While this may be necessary, the focus needs to be on implementation and enforcement rather than modification of these policies and procedures.

Summaries of GAO and Defense Reports on Government-Furnished Material

U.S. General Accounting Office Reports

Need for Improvements in Controls Over Government-Owned Property In Contractors' Plants (B-140389, Nov. 1967)

We reported on the need for DOD to improve its system of controls over government-owned facilities and material in the possession of contractors. The accounting systems employed by contractors did not provide for financial control, and in most instances, acceptable physical inventories of government-owned material were not conducted. Weaknesses were attributed to vague Armed Services Procurement Regulations (ASPR) instructions, deficient physical inventory taking, and departure from good property management procedures.

We recommended to the Secretary of Defense that ASPR be amended to require financial accounting controls for government-owned material in the possession of contractors.

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

Material management procedures at the Los Angeles Air Force Station did not provide control over Air Force material and would not preclude misappropriation from occurring. The lack of control occurred despite a general compliance with Air Force regulations; therefore, this situation could exist at other Air Force locations.

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

In a June 1970 report we advised the Secretary of Defense that inadequate administration of government property by contractors and the services had resulted in (1) unnecessary investment in inventory, (2) increased transportation costs, (3) possible unnecessary procurement, and (4) potential shortages at some locations. One of the underlying causes of the deficiencies was inadequate surveillance of contractors' performance by responsible property administrators. Generally, the services agreed with the findings and said corrective actions were being taken.

However, a February 1974 internal DOD audit report said little, if any, management attention was being paid to the control of GFM in contractor plants.

Increased Use of Available Aviation Assets in New Production Can Save Millions (LCD-79-201, Mar. 1979)

The Navy needed to improve its procedures and practices for (1) identifying quantities of items in long supply that could have been used in new production of aviation equipment, (2) advising contractors of the availability of long supply items, and (3) having items furnished to contractors with equitable reductions in the appropriate contract prices. Substantial savings were available in inventory holding and procurement costs through timely utilization of long supply assets.

Our review of the Navy's performance showed:

- lack of management emphasis and interest on the part of personnel responsible for administering the program,
- ineffective implementation of and noncompliance with existing policies,
- weaknesses in existing procedures and practices, and
- lack of visibility and feedback systems at top management levels of the Navy and DOD for monitoring and measuring the success of the Navy's program for making maximum use of available aviation system assets in new production.

The Army Should Increase Its Efforts to Provide Government-Furnished Material to Contractors (LCD-80-94, Aug. 1980)

By not screening long supply inventories for possible use as GFM on production contracts, four Army inventory control points may have been losing the opportunity to achieve significant savings or may have lost future opportunities. Such screening, which is required by Defense and Army policy, was performed by one Army control point with beneficial results. However, Army commands did not adequately exercise their oversight responsibility to ensure compliance with this policy.

Weaknesses in Accounting for Government-Furnished Materials at Defense Contractors' Plants Lead to Excesses (FGMSD-80-67, Aug. 1980)

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

- Naval Sea Systems Command (NAVSEA) activities involved in GFM procurement lost sight of items located in both the contractors' and SUPSHIPS' warehouses. This created the potential for unneeded procurement.
-

Department of Defense Reports

Defense Supply Agency

Audit of Government-owned Material at Selected Overhaul and Maintenance Contractors (Oct. 1976)

Surveillance of contractors' property control systems was inadequate. Tests of GFM at 66 contractors disclosed about \$9.2 million of material was used on commercial work, sold to the government as contractor-furnished material, or acquired without contractual authority or in excess of needs.

Defense Audit Service

Administration of Maintenance, Overhaul, and Repair Contracts (May 1978)

Long-standing deficiencies still continue in the acquisition and use of GFM by contractors and the surveillance of the requirements and use of material by DOD property administrators. We recommended that DOD should limit the access of repair contractors to the DOD supply system and require contractors to finance inventories of material.

President's Council on Integrity and Efficiency

Summary Report on Audit of Government Property in the Possession of Contractors/Grantees (Aug. 1983)

This interagency audit report summarized the internal control problems identified in over 30 agency audit reports on government property provided to contractors and grantees. Internal controls over the acquisition and accountability for government property in the possession of contractors were weak. These weaknesses resulted in unnecessary program costs and the loss of government property.

Air Force industrial fund had to absorb losses for noncredit returns of about \$246,800 because at the time of return, this material was excess to Air Force needs.

Computer Controls Over Material Furnished to Repair Contractors (July 1978)

Test transactions showed that contractors could bypass the existing controls over GFM requisitions without being detected and requisition material from the DOD supply system. In a 5-month period the system processed billings for 720 shipments valued at \$444,000, which was not recorded in the Air Force system. These disparities were caused by the contractors sending requisitions directly to the source of supply rather than the funding Air Logistics Center.

Air Force Managed Sensitive and Pilferable Items (Mar. 1981)

Contractors could request and receive unauthorized GFM. Five intentionally miscoded requisitions were entered into the Air Force DO32 system. Four of the requisitions were processed, and supply distribution personnel moved material to the shipping area before they were stopped. Invalid requisitions were processed because procedures did not require material management personnel to match GFM shipments with requests made by other Air Logistics Centers.

Review of Government Property in the Possession of Contractors, Air Force Plant Representative Office, Rockwell International, North American Aircraft Operations, El Segundo, Calif. (945-12, Feb. 1983)

The Rockwell International, El Segundo, plant had deficiencies in the way property was acquired and accounted for. Problems existed in the areas of property inventories, record accuracy, acquisition methods, and classification of equipment. The property administrator at the plant had reportedly made no property survey since 1978.

Review of Government Property, Air Force Plant Representative Office, Lockheed-Georgia Company, Marietta, Ga. (975-7, Mar. 1983)

Government controls were adequate to ensure that contractor procedures and practices for acquiring government property followed contractual provisions. The property administrator's property surveys were accurate, reliable, and timely. However, government materials on hand were excess to contractual requirements, but the property administrator

Control over GFM at U.S. Army Electronics Command, Ft. Monmouth,
N.J. (Feb. 1977)

Accounting procedures and controls were inadequate over GFM and did not provide the required financial control. Subsidiary accounting records for material by specific contracts were not established.

Control over GFM Aviation Items (July 1977)

Accounting controls over GFM were not adequate to prevent losses. Property administrators did not make annual property surveys. Inventory records used by contractors to account for GFM were inaccurate. Requisitioning and use of GFM were not adequately controlled. Adjustments of \$1.5 million were needed on 56 high-dollar items to correct contractors' inventory records.

Government-Furnished Property, U.S. Army Plant Representative
Office, Boeing Vertol Company, Philadelphia, Pa. (EC 83-601, Mar.
1983)

The contractor proposed building new special tools; however, he used some tools the Army already owned. This reduced the contractor's overall costs and could have led to the Army's paying about \$1.7 million in incentive fees. Also, the contractor did not adequately identify or report excess government-furnished material. According to records, about \$2 million of excess government-furnished material was on hand at the contractor's plant. A portion of the excess material could have been used to satisfy other Army needs.

Although the contractor had good accountability over government-furnished property, its internal controls over transactions dealing with government-furnished material rejected from the production line or sent to subcontractors were inadequate. The contractor had not returned about \$146,700 of the government-furnished material to its government property unit. Many of the missing items were found commingled with contractor-owned stocks, increasing the potential for losses of Army material.

Navy Inspector General

Supervisor of Shipbuilding, Conversion and Repair, USN, Boston, Mass.
(May 1978)

There was no specific instruction on disposition of excess GFM in possession of contractors. The division was making a strong push to clear out fairly substantial amounts of GFM that had been gathering at contractor's plants over several years.

Supervisor of Shipbuilding, Conversion and Repair, USN, Newport News, Va. (Nov. 1978)

Four SUPSHIPS and 14 contractor audits scheduled for calendar year 1978 were not conducted. The contractor was holding an estimated \$8 million of excess government property. As of October 27, 1978, 200 excess defective repairable items were held by the contractor; 120 of these for more than 90 days.

Naval Audit Service

Supervisor of Shipbuilding, Conversion and Repair, USN, Newport News Shipbuilding and Drydock Co., Newport News, Va. (Aug. 1976)

The contractor's system for controlling GFM did not satisfy requirements of the Armed Services Procurement Regulations as incorporated into shipbuilding contracts. The most recent inventory showed the total inventory on-hand value was \$200 million. The approved system did not provide for periodic physical inventories.

Naval Plant Representatives' Office, Long Beach, Calif. (Jan. 1978)

About \$2.3 million of government-furnished aeronautical equipment in the hands of the contractor was excess and not effectively used by the Naval Air Systems Command. Review of the supply status showed outstanding current procurement actions valued at over \$400,000 could have been avoided if the excesses had been turned in.

Supervisor of Shipbuilding, Conversion and Repair, Pascagoula, Miss.
(Mar. 1979)

There was no adequate procedure within the Navy for disseminating information as to what components furnished to private contractors as GFM were under warranty. GFM was not being administered in accordance with pertinent directives. For example, a property system survey plan was not developed and the annual system survey was not being done.

Phase I of the Interservice Audit of Government-Furnished Material in the Possession of Contractors and Grantees. (Aug. 1983)

Two contractors were provided about \$1.1 billion of GFM under two contracts for the construction of aircraft carriers and submarines, but never performed periodic physical inventories as required by the DAR.

Audit of Government-Furnished Property in the Possession of Contractors and Grantees—Phase II (G 20052, Sept. 1983)

This audit included work at Naval Plant Representatives Offices (NAVPRO) located at St. Louis, Missouri, and Pomona, California; at the Supervisor of Shipbuilding, Conversion and Repair, Groton, Connecticut; and the Naval Submarine Bases (SUBASE) Bangor, Washington, and Kings Bay, Georgia.

The property control systems contractors used at SUBASE Bangor and NAVPRO Pomona to account for government-furnished property were not always adequate. Government representatives at these two activities as well as at SUPSHIP Groton did not perform the required checks of the integrity of contractors' property control systems. In some instances, adequate control over the acquisition of government-furnished property did not exist at the two SUBASES and at the NAVPRO.

A Review of Procurement, Property, and Other Selected Functions at the Supervisor of Shipbuilding, Conversion, and Repair, USN, New Orleans, La. (June 1984)

SUPSHIP could not provide the specific dollar value of GFM that was in the possession of two contractors although they acknowledged that the amount could exceed \$75 million. The reliability of the contractors' property systems was not assured since the property administration functions were not adequately performed.

Contract Administration, Procurement, and Other Selected Functions at the Naval Plant Representative Office, Stratford, Conn. (May 1985)

A contractor with over \$303 million of government-furnished property including \$36 million of GFM, operated with outdated and incomplete property control procedures. Some of the procedures, which had been approved in the early 1970s, were not updated. As a result, there was no assurance that the property was adequately controlled.

Contract Administration, Procurement, and Other Selected Functions at
the Naval Plant Representative Office, Bethpage, N.Y. (June 1987)

A contractor retained about \$114.5 million of material from completed contracts and held an additional \$7.1 million, even though there had been no demand for the material for a 12-month period. As a result, the government (1) may have acquired up to \$121.6 million in unneeded material and (2) may have been unnecessarily charged for storage costs. The responsible Navy command agreed that of the \$114.5 million, \$36.7 million represented potential excess. The command claimed that the remainder was required by the contractor. The Naval Audit Service disagreed and requested that the Navy review the matter. The Navy-responsible command agreed that the additional \$7.1 million was excess and requested disposition instructions.

Also, property administration was not performed or insufficiently performed to adequately evaluate the contractors' property system, which controlled \$3.4 billion of government-furnished property located in 5 states and at about 400 subcontractors. This deficiency was attributed to an insufficient number of government personnel assigned to property administration.

Report of the House Committee on Government Operations, Subcommittee on Legislation and National Security, "Inadequate Control Over Government Material Furnished to DOD Contractors" (Dec. 10, 1981)

DOD has failed to adequately control billions of dollars worth of GFM provided to its contractors, and DOD's policy of relying almost solely on contractors for accounting controls for the GFM was ineffective. The lack of these controls led to GFM being provided in excess amounts to contractors, sold back to DOD, or used on commercial contracts.

DOD recognized that there was unauthorized access by contractors to the DOD supply system, misuse of GFM, and other losses of GFM because of a generally less than satisfactory system of control and accountability over GFM.

Recommendations included, among other things, that DOD

- centralize management and accountability of GFM in one adequately staffed office,
- test the practicability of selling material to contractors instead of providing it free of charge,
- control production contractors' access to DOD's supply system, and
- employ more property administrators assigned to contractors' plants and develop a plan to install accounting controls over GFM.

Report of the House Committee on Government Operations, Subcommittee on Legislation and National Security, on "Costly Failure to Control Government Property Furnished to Defense Contractors Remains Uncorrected" (May 21, 1985)

Despite the continued criticism, DOD still lacked internal controls over much of the \$40 billion worth of government-owned property in contractor hands. Implementation of existing regulations remained inadequately implemented. DOD was unable to control access to and account for much of this property, so contractors were able to acquire more than they needed or were entitled to under their contracts, to disregard obligations for proper maintenance, to "lose" property without penalty, and use it in commercial production without renumeration of the government.

The Committee called for (1) DOD's efforts to install appropriate accounting controls over GFM to be accelerated, (2) plans for implementing the MCA concept contained in DODI 4140.48 to be expedited, (3) the control

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requirements to be extended from maintenance to production and supply contractors, and (4) the concept of selling material to contractors instead of providing it free of charge to be retested.

Report of the House Committee on Government Operations, Subcommittee on Legislative and National Security, on "Misuse of Government Equipment In Defense Production" (Apr. 29, 1986)

Defense and military services have a long way to go to achieve a substantial reduction in the costs of furnishing government-owned equipment to defense contractors. Major factors impeding progress include

- the vagueness of the FAR and the lack of adequate guidelines;
- limited Defense efforts to motivate contractors to provide their own equipment;
- lack of sales of government-owned plants;
- continuing management oversight problems at field and headquarters levels regarding the acquisition, use, retention, and disposal of GFE; and
- limited visibility over GFE in the possession of contractors.

Recommendations included, among other things, that DOD speed up its efforts to install appropriate accounting controls over government-furnished property, including GFE.

Summaries of Congressional Reports on Government-Furnished Material

Report of the Subcommittee on Economy in Government, Joint Economic Committee, on "Economy in Government Procurement and Property Management" (Apr. 23, 1968)

The report said the DOD must make a much greater effort to enforce its stated policy that contractors provide their own facilities and materials incident to the performance of government contracts. DOD has failed to establish adequate controls over the inventory of its approximately \$15 billion of property furnished to contractors and contractors' accounting systems were found to not provide for financial control. In most instances, acceptable physical inventories of government-owned material were not being taken properly.

Report of the House Committee on Appropriations on "Department of Defense Appropriations Bill," 1979 (July 27, 1978)

The Committee was concerned that by allowing DOD maintenance contractors to requisition material from the government's supply system, abuses were possible and could take place. DOD's response to this situation was to add more people at contractor plants and inventory control points. The Committee believed that much of the problem could have been avoided simply by allowing contractors to use the supply system, but also requiring them to pay cash for materials requisitioned.

Report of the House Committee on Appropriations on "Department of Defense Appropriation Bill," 1980 (Sept. 20, 1979)

The report commented on the prior year report and noted that DOD was asked to undertake a test by restructuring a portion of the maintenance contracts to allow the contractor to use the Defense supply system on a cash basis rather than on a GFM basis.

The Committee directed DOD to test a cash payment program for the provisioning of consumable supplies on maintenance contracts. The Committee hoped that the test would (1) provide a check on the price of the government procured items because the contractors would not use the government system when they could buy the items from commercial sources at less cost, (2) prevent the contractors from ordering far more than they needed, (3) save manpower to police the system and expand new control mechanisms, and (4) eliminate unnecessary record-keeping.

Internal Controls, Contract Administration, Property Administration,
and Financial Management at Naval Plant Representative Office, Laurel,
Md. (Mar. 1986)

Navy oversight at a contractor who had \$138 million of government property at a university and several remote locations was inadequate. Problems cited included (1) property surveys that were not performed at six remote locations that had about \$4.7 million of government property and (2) documentation that was not available to support the Navy's approval of the contractor's property control system. One reason for not surveying the remote locations was the lack of property administration personnel.

Addendum to: Contract Administration, Procurement, and Other
Selected Functions at the Naval Plant Representative Office, St. Louis,
Mo. (Aug. 1986)

A contractor retained about \$126 million of government property in support of aircraft programs that did not have any demand during a 12-month period. An additional \$20 million of excess government property was identified that supported the contractor's missile program. About \$50 million in potential savings could have been realized by redistributing or disposing of GFM inventories that appeared excess to requirements. The responsible Navy Command concurred with the results and (1) transferred \$30 million of the excess inventory to other users, (2) disposed of \$5 million because it was obsolete, and (3) agreed to review the remaining excesses to determine the benefits to be gained from redistribution and disposal.

Selected Aspects of Range Operations at the Pacific Missile Test Center,
Pt. Mugu, Calif. (Sept. 1986)

The Navy was deficient in its oversight of government-furnished property valued at \$41.3 million provided to its contractors at the Navy's Pacific Missile Range Facility, Kekaha, Kauai, Hawaii. The last annual property survey was performed in 1984, but survey documentation was only a brief narrative and did not include information necessary to support the conclusions reached concerning the adequacy of the contractor's controls. These conditions existed primarily because a full-time property administrator had not been assigned to the contract.

Fleet Combat Direction Systems Support Activity, Dam Neck, Virginia Beach, Va. (July 1979)

The contractor received 1,652 items of GFM with an estimated replacement cost of over \$250,000. There was virtually no control over the property, since neither the contractor nor property administrator complied with the Defense Acquisition Regulations.

Multi-Location Audit of the Aviation Supply Offices' Management of GFM (Nov. 1979)

The audit service identified that about \$10.6 million of GFM consumable material in the possession of contractors was excess to their needs. Excess material valued at about \$1.1 million could have been used to satisfy 209 backordered requisitions, including 113 high priority requirements, and reduce or eliminate existing or planned procurements. An estimated \$20 million of the total GFM identified in the possession of contractors may have been excess to contractor needs, and excesses valued at about \$2.1 million could have been used to satisfy other system requirements. Overall, the Aviation Supply Office's management control over GFM was minimal and less than desirable. Consequently, the advantages of providing GFM were not being achieved.

Supervisor of Shipbuilding, Conversion and Repair, USN, Newport News, Va. (Apr. 1980)

The contractor had not provided satisfactory revisions to his property control system 6 years after the audit. Required annual surveys of the system have not been conducted since 1977. Also, the contractor had not taken periodic physical inventories of all government property as required. Consequently, there was no assurance that government property in possession of the contractor was adequately controlled, preserved, and maintained.

Supervisor of Shipbuilding, Conversion and Repair, USN, Long Beach, Calif. (Mar. 1981)

SUPSHIP needed to improve inventory control procedures for excess GFM. No comprehensive list of all items was maintained, records did not show actual status, and items without an identified future need were not returned to the Navy Supply System.

Government-Furnished Property, U.S. Army Plant Representative Office, Bell Helicopter—Textron, Fort Worth and Amarillo, Tex. (SW 83-600, Mar. 1983)

Management of government-furnished property in the functions reviewed was not adequate. Regulatory guidance related to government-furnished property was not always followed, and better management of government-furnished property in the hands of the contractor was needed. The need for replacing or transferring special test equipment to follow-on contracts was not validated. Required property surveys were not performed and accountability over government-furnished material was inadequate.

Government-Furnished Property, U.S. Army Aviation Research and Development Command and U.S. Army Troop Support and Aviation Material Readiness Command, St. Louis, Mo. (MW-83-602, May 1983)

The audit showed that analyses supporting the decisions to have the government provide materials to contractors were not made and documented. Also, excess material items at the contractor's plants were not adequately identified, reported, and used to reduce follow-on contract requirements. In addition, controls were not adequate to insure proper financial accountability and visibility over the property.

Audit of Government-Furnished Property (EC 83-605, June 1983)

The management of government-furnished property in some functions was not adequate, and management improvements could have resulted in substantial cost savings. Contractors and Army property administrators were not adequately identifying and reporting excess government-furnished material. Procedures were not issued to help activities determine whether the government or the contractor should furnish property (needed or required) to fulfill the contract. The contractors did not always adequately account for and safeguard the property furnished by the government, and inventory losses occurred.

Annual property surveys of contractor internal control systems were not always performed or were not performed thoroughly enough to detect internal control weaknesses at contractor plants. Also, general and subsidiary ledger accounts for government-furnished property were not maintained. The balances were inaccurate and could not be used either as internal controls or to help maintain visibility over property provided to contractors.

had taken no action. Property accountability records, showing location and identity data, were not always accurate. Also, government equipment was used without proper approval or authority.

Internal Controls Within Systems for Managing Materiel Furnished to Maintenance Contractors (5126113, Jan. 1986)

Air Force maintenance contractors bypassed existing management control activities controls, then requisitioned and received unauthorized and unneeded materials and the contractors failed to cancel outstanding GFM orders (back orders) after contracts were completed. Also, an expensive Air Force computerized system to monitor and control GFM held by maintenance contractors was ineffective.

Government-Furnished Material at Contractor Facilities (6076410, Feb. 1987)

We identified several areas where GFM controls could be improved at several Air Force Commands, Air Logistics Centers, and at six contractor locations. Specifically, the GFM transaction reporting system did not provide accurate and timely information; controls limiting contractor access to DOD material inventories for research and development and production contracts were not effective; and implementation of the Air Force GFM financial accountability system had slipped and could have been further delayed because of unresolved issues.

GFM problems at contractor locations included excess GFM valued at \$1.3 million at 4 of the 6 locations reviewed, the transfer of about \$14 million in assets to other contracts without Air Force assessment of the appropriateness of the action, and the commingling of contractor material with GFM.

Army Audit Agency

Control over GFM, U.S. Army Bell Plant Activity (Nov. 1976)

Annual surveys of the contractor's property control system were not made. The contractor had problems in maintaining controls over GFM. Physical inventory of 37 high-dollar value items showed that adjustments of \$1.4 million were needed on 20 items to make inventory records agree with on-hand balances.

Contractors acquired and retained more property than they needed for the contracts because of inadequate acquisition guidelines and government oversight. Contractors had few incentives to finance needed property or to exercise prudence in acquiring property with government funds. Weak government and contractor controls resulted in unneeded purchases. The government did not maintain independent financial controls and relied on contractor controls, even though many of the contractors had inadequate property control systems.

With no incentives to maintain effective internal controls for property, contractors had little financial liability for lost or damaged property. As a result, the government did not know how much of its equipment contractors had; contractors did not properly safeguard government property; and program costs increased because of property losses and unneeded property bought by contractors.

DOD Inspector General

Government-Furnished Material at DOD Production Contractors, DOD-IG
Audit Report (84-032, Feb. 1984)

The DOD Inspector General (IG), the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency audited the use of GFM by production contractors. The audits showed that the special reports on GFM, requested by the Office of the Secretary of Defense from the military departments, were inaccurate and incomplete. In most cases, the contractors and cognizant property administrators had not been contacted to respond to the OSD request for data on GFM.

Excess material worth \$24.8 million was found at 14 of the 15 production contractors reviewed. This excess resulted from DOD activities shipping more material than required to production contractors and from contractors ordering more than required. Some of the excess material could have been used to satisfy operational requirements of the services.

Air Force Audit Agency

Management of Depot-Level Contract Maintenance (June 1978)

There was a lack of visibility and control to preclude repair contractors from requisitioning unneeded GFM from the DOD supply system. Comparison of contractor actions on the same item showed that out of \$1 million of GFM requisitioned, \$1.3 million was returned to the Air Force. The

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

The Navy was not Adequately Protecting the Government's Investment in Materials Furnished to Contractors for Ship Construction and Repair (PLRD-81-36, June 1981)

The Navy needed to make improvements in its management of GFM to ensure the government's investment was adequately protected.

The Navy had no central point of control or accountability for GFM. Instead, many commands were involved in its management, and their efforts were not coordinated to prevent duplication or to ensure consistency. These problems were compounded by the lack of inventory manager visibility over GFM in the possession of the Navy's Supervisors of Shipbuilding, Conversion and Repair (SUPSHIPS) and contractors. Moreover, no activity regularly monitored the performance of the various SUPSHIPS to ensure consistent interpretation and application of GFM regulations and directives.

Although the SUPSHIPS' basic regulations and directives for GFM management were the same, SUPSHIPS did not interpret and apply these in the same manner. As a result, their effectiveness in managing GFM varied widely.

The Seattle SUPSHIP was managing GFM in a more effective manner by enforcing Defense Acquisition Regulation (DAR) requirements on contractors and by using an in-house computerized monitoring system for management prior to delivery to the contractor.

The failure of three other SUPSHIPS to fully enforce DAR led to inaccuracies and inefficiencies in contractors' GFM control systems, caused excess items to be held for extended periods of time, and inadequately protected the government's interest.

Other areas need improvement:

- Unnecessary costs may have been incurred when SUPSHIPS did not screen excess new GFM against future needs.

Our follow-up work found weaknesses in the accountability procedures for GFM. For example:

- Air Force contractors ordered government materials directly from government supply systems and received direct shipments with little or no Air Force surveillance.
- There was no established way to find out from government sources the amounts of materials ordered and received from contractors.
- Contractors' consumption of government material could not be compared against expected or planned use rates because the material requirements lists provided by the Air Force to contractors were incomplete and/or inadequate.

When the records of materials given to contractors were kept by contractors, who also had physical custody of these materials, we believed minimum acceptable control would require a way for government representatives to verify contractor reports of materials received, used, and remaining in inventory. Independent verification and evaluation would require the following:

1. A government record by national stock number, quantity, and dollar value of the government material given to individual contractors. This could be done by furnishing government property administrators with information on government material shipped to contractors.
2. Periodic verification of the accuracy of contractors' records by comparing them with the government's records of material shipped to the contractors and auditing contractors' usage reports. In addition, the practice of taking physical inventories of materials on hand should be continued.
3. Preparation of better estimates of expected usage of government-furnished material. This includes periodic evaluation of the reasonableness of such estimates and appropriate adjustments when necessary.

DOD advised us that a joint Air Force/Defense Contract Administration Service task force was studying the problems of controlling government-furnished material, and therefore it felt additional directions to those agencies were unnecessary.

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In summary, DOD and the services have had long-standing problems with the management, control, and accountability for property—material and equipment—they have furnished to contractors. These problems continue.

- DOD has not effectively implemented the basic government policy of relying on contractors to provide all the property needed for government contracts, except when it can be demonstrated that it is in the government's best interest to do so.
- The DOD and service regulations designed to control contractor material requisitions submitted to the DOD supply system have either not been implemented or were inadequately implemented.
- The provisions of the FAR that require contractors to account for and safeguard government property in their possession and the government to maintain oversight over the contractors' management of the property have not been adequately enforced.
- DOD and the services have made slow progress in developing and implementing financial property accounting systems, which would give the government independent data for judging the accuracy of the contractors' records.

As a result, there is no assurance that the government's sizeable investment in property has been adequately protected; the potential for waste, fraud, and abuse is minimized; and maximum benefits accrue to the government.

To ensure that these actions are actually implemented, we recommend that the Secretary of Defense establish firm milestones for implementing each of the actions and direct his Inspector General to independently monitor and report on the progress made by the DOD components.

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- vague FAR and Defense FAR Supplement provisions, which had allowed government officials to permit contractors to acquire new, general purpose equipment, such as office equipment and vehicles;
- limited Defense efforts to motivate contractors to provide their own equipment;
- inadequate equipment acquisition guidelines, especially for service contractors; and
- continuing management oversight problems at field and headquarters levels over the acquisition, use, retention, and disposal of GFE.

Other factors that have hindered efforts to reduce GFE include (1) legal uncertainties surrounding disposal of equipment at contractor-owned, contractor-operated plants and (2) limited efforts by the Army and Navy to determine the prospects for selling government-owned, contractor-operated plants.

The report recommended that the Secretary of Defense develop an overall strategy for reducing GFE. As part of this strategy, we recommended, among other things, that the Secretary direct

- the Defense Acquisition Regulatory Council to take steps to amend the DOD FAR Supplement to allow the military services and defense agencies to provide general purpose equipment to contractors only under highly unusual circumstances, which are clearly defined, adequately controlled, and properly justified;
- his office and the Army, Navy, and Air Force to develop specific guidelines for program managers and local contracting officials to use in determining when and under what conditions the government can provide general purpose equipment to service contractors;
- the three services to (1) identify general purpose plant equipment acquired by contractors under other than facilities contracts and (2) determine and recoup any improper profits or fees that were added as a result of such acquisitions;³
- the Army and the Navy to undertake comprehensive reviews of their government-owned, contractor-operated plants to determine which ones could be sold, and then to consummate such sale; and
- his office to establish an adequately staffed central office for government-furnished property, including GFE. This central office should have at a minimum, information on the quantity and value of GFE acquired annually by each service, how it is being used, and how much is being

³Facilities contracts allow the government to reimburse the contractor for only the actual cost of the equipment, with no add-ons for profit or fees.

Accountability and Financial Controls

Since 1967, we—as well as congressional committees—have criticized DOD and the services for not having established property accountability and financial accounting controls over GFM. We recommended in two reports 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.

In October 1983 DOD published its accounting manual, DOD 7220.9-M. This established financial property accounting principles to be implemented by the services in their accounting systems. The manual also includes general ledger control accounts for material and equipment. The services are currently developing accounting systems, which they plan to implement by late 1989. When the accounting systems are developed, they would provide government property administrators with independent data that could be used to judge the accuracy of DOD's new property accountability system discussed below.

In the property accountability area, DOD established a database system in August 1986 called the "Department of Defense Industrial Property Management System." This system is to provide managers with sufficient visibility to adequately manage government-owned assets that are under their responsibility. Specifically, using contractor records, the system tracks the beginning and ending fiscal year on-hand balances of all DOD property on a contract-by-contract basis. The balances are expressed in terms of quantity, except for material and real estate, and dollar value. DOD has completed its data collection effort for fiscal year 1986 and reported its result. It is now working on fiscal year 1987 data.

While the actions taken by DOD in the property accountability area are steps in the right direction, we have concerns with the accuracy and completeness of the data reported. Our review of the 1986 DOD property report disclosed that it was incomplete, because not all contractors with property had submitted the required data. For example, three Navy contractors we reviewed, who had about \$21.2 million of GFM under three contracts, had not reported the necessary data. Another Navy contractor who had reported did not include two contracts with material value at about \$22.5 million in his data submission. The same contractor also did not include GFM values for over 56,500 line items out of a total of over 65,700 line items on 4 other contracts. The value of the remaining 9,200 line items was about \$59.6 million. In addition, a 1987 Naval Aircraft Service report disclosed that a contractor had overstated the GFM value on his records by \$1.5 billion. The report also pointed out that the Auc

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- Contractor officials also agreed that the property control system problems were long-standing and said that they would take corrective action.
- Another Navy contractor, who had accumulated \$2.4 million of potential excess GFM under one contract, did not record more than \$670,000 of GFM on its property records. The government was not aware of this omission, since there was no government property administrator assigned during fiscal year 1986. The property administrator told us that during fiscal year 1987, he was not given the authority by the contracting officer to review the contract and the contracting officer did not have the staff to do it. Contractor personnel agreed that they should have accounted for the material until it was actually used and said they would begin accounting for GFM in this fashion.
 - A May 1985 Naval Audit Service report stated that a contractor with over \$303 million of government-furnished property, including \$36 million of GFM, operated with outdated and incomplete property control procedures. Some of the procedures, which had been approved in the early 1970s, had not been updated. The report concluded that, as a result, there was no assurance that the property was adequately controlled.
 - The Naval Audit Service in an August 1986 report stated that, although the property administrator's annual surveys showed that a contractor adequately controlled his \$526 million of GFM, substantial quantities of excess material (\$146 million) may have accumulated. This condition existed because inventory tests performed by the property administrator were done only to verify that material issued from government stocks was authorized. Such tests would not detect excess material on program-wide basis. The Navy concurred with the report and has (1) transferred \$30 million of the excess inventory to other users, (2) disposed of \$5 million because it was obsolete, and (3) agreed to review the remaining excesses.
 - At an Air Force contractor, the government 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 the responsible Air Logistics Center lacked sufficiently detailed information on such things as item descriptions, part replacement rates, and item costs. Over \$360,000 of GFM was on hand in early 1987, and a contractor official believed that most of it was excess to existing needs.
 - At one Air Force Base, neither the contracting officer nor the acting property administrator knew that one contractor did not maintain

were limited coordination between Army organizations involved in supply and contracting and a lack of resources thought necessary to establish and maintain MCAS. DOD projects full Army MCA implementation by June 1989.

- The Navy has not yet established an MCA at its Ships Parts Control Center or fully implemented a MCA at the Aviation Supply Office. At the Supply Office, the MCA controlled only 37 of 117 maintenance contracts. The remainder was not controlled. The Supply Office has started to develop a new, automated MCA system, which it expects to be fully operational by December 1989.

The Air Force has established MCAS to control GFM for its maintenance contracts. However, current Air Force procedures and practices for reviewing, validating, and approving GFM requisitions do not ensure that contractors requisition and receive only needed items and amounts of GFM. This has occurred for a number of reasons.

- The Air Force has not properly implemented a regulation that requires the identification of specific parts and quantities needed by contractor to execute maintenance contracts. As a result, contractors have had access to and have ordered unneeded material. For example, in its 1986 report on the effectiveness of internal controls on GFM, the Air Force Audit Agency tested 180 out of a total of 1,037 contractor requisitions during a 2-month period (November and December 1984). Of the 180 requisitions, 33 were for unauthorized/unneeded items valued at \$334,000. The Air Force concurred and stated that new procedural guidance would be issued by January 1986. However, our review showed that the potential for obtaining unneeded/unauthorized items still exists.
- The MCA system currently has no checks to prevent a contractor from exceeding maximum part quantities needed to perform a contract, and contractors can avoid edits designed to prevent them from depleting inventory stock levels. For example, one contractor had submitted 45 requisitions, each for 19 electrical parts, for a total of 855 on the same day. The contract limited the contractor to 90 parts. The contractor avoided the maximum quantity of 20 items per requisition for this part by ordering one less part on each request. The multiple contractor requisitions depleted the entire DOD inventory of these parts.
- Some Air Force contractors have obtained GFM without prior MCA review and approval by accessing the supply source directly. For example, the Air Force Audit Agency reported in 1986, that 161 out of a total of over 81,000 material requisitions were filled in this manner. The material obtained was valued at \$137,000. Of the 161 requisitions, 107 requisitions that were submitted by one contractor, valued at about \$95,000,

DOD policy contained in DOD Instruction 4140.48 (Control of Access to DOD Material Inventories Required By Defense Contracts), DOD Instruction 4100.33 (Commercial Activities Program Procedures), and various service directives state that decisions to provide material should be supported by sound rationale and be documented in writing. However, commands and activities we visited were generally not complying with the policy for reasons ranging from being unaware of existing DOD and service policies in this area to following past practices, which presumed that it was inherently less costly and troublesome for the government to provide materials to contractors than for contractors to buy it commercially. For example:

- We reviewed 19 maintenance contracts at 3 Air Force Air Logistics Centers, but only 1 of them contained a written justification for GFM. Officials at one Air Logistics Center stated that none of its 201 maintenance contracts contained the required justifications. Some personnel were not aware of the policy on GFM, and others followed an outdated (1978) regulation, which stated that the government would normally provide, as GFM, parts available in the DOD supply system. This regulation was revised in 1984.
- We reviewed 8 randomly selected maintenance contracts at the Navy's Aviation Supply Office, but none contained written documentation to support the decision to provide GFM, as required by Navy policy. The Supply Office inventory managers said that in recent years they had followed the practice of providing contractors with all material necessary for contract performance.
- Although DOD had a policy since at least 1985 requiring contractors to provide all material necessary to accomplish their service contracts, we found that, with few exceptions, service contracts at Army, Navy, and Air Force installations authorized that all material needed by contractors would be provided as GFM. This happened, even though some of the material was readily available from commercial sources and could be obtained at lower cost. Material provided as GFM included such items as paint, lumber, common hardware, car wax, office and automotive supplies, and videotapes.

On the cost issue, we found instances where contractors could obtain material from commercial sources at substantially lower cost than from

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Government material consists of those items provided from the DOD supply system as government-furnished material (GFM), and items purchased by the contractor with government funds from commercial sources, commonly referred to as contractor-acquired material (CAM). Our review work focused on GFM, except in those instances when the GFM and CAM could not be readily segregated in the contractors' records.

The FAR sets forth the government's policy on providing material to contractors. The regulations state that contractors shall ordinarily furnish all material for performing government contracts. However, material may be provided to a contractor when it is determined to be in the best interest of the government by reason of economy, standardization, the expediting of production, or other appropriate circumstances.

When GFM is authorized, it is provided to defense contractors in two ways—"push" or "pull." Under the push method, the government computes a contractor's material requirements and has the material shipped directly from either its supply system or a third party, i.e., another contractor. The contractor does not submit requisitions to the government for any of the material. Under the pull method, a contractor determines his own material requirements and, upon government review and approval of the requirements, obtains the material either directly or indirectly from the DOD supply system.

To enable certain contractors to requisition, receive, and be billed for GFM, the services assign them six-digit codes, called DOD Activity Address Codes (DODAACS). These contractors are authorized to use their DODAACS and follow standard DOD requisitioning procedures to obtain materials directly from wholesale level supply inventories.² Other contractors obtain material directly by ordering from on-base supply activities, which replenish their stocks from the wholesale inventories, or by having a service's organization order the material directly from the wholesale level which then turns the material over to the contractor for his use.

The FAR and contract provisions prescribe that contractors are responsible for establishing and maintaining systems to control, protect, preserve, and maintain all government property, including GFM. These

²For purposes of this testimony, wholesale inventories refer to materials stored by inventory control points for distribution to retail or base level activities. It includes materials managed by all military services, DLA, and the General Services Administration.

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The following testimony, "DOD's Management of Government Property Furnished to Defense Contractors," was given by Frank C. Conahan, Assistant Comptroller General, National Security and International Affairs Division, on March 21, 1988, before the Committee on Governmental Affairs, United States Senate.

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our work on the long-standing problems that the Department of Defense (DOD) and the military services have had in controlling and accounting for property they furnish to defense contractors. These contractors use the property to develop, produce, and maintain Defense weapon systems and support military installations worldwide.

Results in Brief

DOD furnishes billions of dollars of property to defense contractors each year. However, the exact amount of government property currently in the hands of contractors is unknown. Until August 1986, there was no system in place for periodically reporting the value of government property in the hands of contractors. The data collected by DOD since then shows that as of September 30, 1986, the total was over \$26 billion.¹ However, we believe that the total amount of property on hand may be even larger than the 1986 figure, because contractors' records do not, in many cases, adequately account for this property, and DOD and the services currently have no overall management or financial systems in place that could independently verify contractor records. Also, some contractors did not submit the necessary data for inclusion in the total figure.

Several factors contribute to the problems in controlling and accounting for property furnished to contractors. First, DOD has not effectively implemented the basic government policy of relying on contractors to provide all the property needed for government contracts, except when it can be demonstrated that it is in the government's best interest to furnish it. Second, the services have not yet implemented or have inadequately implemented DOD instructions designed to control contractor access to the DOD supply system. Third, DOD has not adequately enforce the provisions of the Federal Acquisition Regulations (FAR), which

¹ Contractors had an additional \$19 billion of other government property, such as real estate and special tooling, in their possession.

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Table

Table 1.1: Reported Amount of Government Material and
Equipment Furnished to Defense Contractors

We have issued, or will be issuing, separate reports on the military service's and Defense Logistics Agency controls over and accountability for property provided to contractors.³

Based on our reviews in each service and the Defense Logistics Agency, we concluded that several factors have contributed to long-standing problems in controlling and accounting for material furnished to contractors. First, DOD has not effectively implemented the basic government policy of relying on contractors to provide the material needed for government contracts, except when it is determined in the government's best interest to provide needed material. Second, DOD and service regulations designed to control contractor material requisitions to the DOD supply system have either not been implemented or were inadequately implemented. Third, the provisions of the Federal Acquisition Regulation requiring contractors to account for and safeguard government material in their possession and for the government to oversee the contractors' management of this material have not been adequately enforced. Fourth, DOD and the services have made slow progress in developing and implementing financial property accounting systems. Most of the problems associated with providing government-furnished material to contractors are also applicable to government-furnished equipment.

Our reports on the results of our reviews of each military service and DLA contain our specific findings and recommendations. The services have agreed with all of our recommendations to date and have identified various actions to implement them. Also, DOD and the services have taken actions to address the problems and recommendations made in past audit reports by us and DOD audit organizations on government material and equipment provided to contractors. To ensure that all of these actions are implemented in a timely fashion, we recommend that you

- establish specific milestones for each action and
- direct your Inspector General to independently monitor and report on the progress made by the services to implement each action.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations

³Internal Controls: Air Force Can Improve Controls Over Contractor Access to DOD Supply System (GAO/NSIAD-88-99, Mar. 18, 1988); and Internal Controls: Status of Army Efforts to Control Contractor Access to the DOD Supply System (GAO/NSIAD-88-98, Mar. 11, 1988).

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