DEPARTMENT OF DEFENSE

AUDIT REPORT

GOVERNMENT-FURNISHED PROPERTY ADMINISTRATION
AT THE DEFENSE NUCLEAR AGENCY

No. 90-060

April 18, 1990

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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April 18, 1990

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY
DIRECTOR, DEFENSE NUCLEAR AGENCY

SUBJECT: Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Report No. 90-060)

This is our final report on the Audit of Government-Furnished Property (GFP) Administration at the Defense Nuclear Agency (the Agency). The audit was made from August 1988 to June 1989. The overall objective of the audit was to determine if GFP provided by the Agency to contractors and other users was controlled and administered in accordance with DoD policy, guidance, and procedures. Specific audit objectives were to determine the effectiveness of measures taken to limit the amount of GFP in the hands of contractors, to encourage private sector investment and financing, to improve reporting procedures, and to improve property management functions with particular emphasis on accountability and disposition of GFP. We also evaluated the adequacy of internal controls over GFP and assessed the adequacy of actions taken to implement recommendations contained in Office of the Assistant Inspector General for Auditing, DoD, Report No. 83-107, "Management of Research, Development, Test and Evaluation Capital Equipment, Defense Nuclear Agency," April 21, 1983.

Under the terms and conditions of contracts awarded with GFP, contractors were required to maintain the official property records, to establish property control systems, and to generate annual reports of DoD property in their custody. Property control systems are required to be surveyed by Government property administrators at the time of contract award and at least annually thereafter to ensure that contractual requirements and provisions of the Federal Acquisition Regulation (FAR) are achieved. GFP administration for the contracts that we reviewed in this audit was delegated to the Defense Contract Administration Services (DCAS). Redistribution and disposal screening of GFP no longer needed for contract performance was performed by the Agency. The Agency provided GFP costing more than $94 million to 52 contractors for use in the research of technologies and techniques to improve the security and survivability of nuclear weapon systems. We reviewed about $81 million of the $94 million of GFP in the custody of 11 contractors.

The audit showed that the Agency generally employed good property management practices. The Agency limited the amount of GFP in the custody of contractors, encouraged private sector investment in and financing of property, and provided GFP to contractors only when it was clearly established to be in the best interest of the Government to provide the property. Additionally, contractors were using GFP provided by the Agency for the purposes authorized in the contract. Further, the Agency implemented all recommendations in our prior audit report. However, the Agency's property management practices needed improvement to provide better accountability and control of GFP in the custody of contractors and to provide prompt screening of GFP for redistribution and disposal when it is no longer required for contract performance. DCAS property administrators had not made property surveys in accordance with established criteria to detect weaknesses and errors in property control systems and to improve the accuracy of prescribed reports. The Defense Logistics Agency had not implemented internal controls in the DoD Contract Property Management System to aid in detection of report errors and omissions. The results of the audit are summarized in the following paragraphs, and the details, together with the audit recommendations and management comments, are contained in Part II of this report.

The Agency's plant clearance functions, designed to redistribute or dispose of GFP excess to contractual requirements, were not performed effectively or in a timely manner. Further, the plant clearance functions were not in compliance with DoD policies. As a result, there were major delays in the removal of almost $7 million of the excess GFP from the custody of Agency contractors. About $5.3 million of the excess GFP was left in the custody of contractors for up to 30 months awaiting disposition instructions. Additional GFP, costing about $161,000, was retained by contractors who did not request disposition instructions. Finally, about $1.2 million of excess GFP was stored in a Government-owned, contractor-operated plant for up to 19 years without the Agency identifying this condition, justifying the need to retain the property, and recording the property in Agency accountable property records. We recommended that the Agency delegate duties associated with the plant clearance of excess GFP to the DCAS. We also recommended that the Agency develop and implement accountability and control procedures for GFP not assigned on contracts, and for reutilizing and redistributing GFP no longer needed for contract performance (page 5).

The Defense Logistics Agency (DLA) did not fully comply with established requirements regarding the management, control, and

reporting of GFP in the custody of eight contractors engaged in nuclear research. Also, the DoD Contract Property Management System, maintained by the DLA, did not contain sufficient controls to detect errors or omissions in reported costs of GFP. As a result, loss, unauthorized use, or misappropriation of GFP could occur without detection, and reported costs of GFP were misstated by almost $57 million. We recommended that the Director, DLA, direct the DCAS property administrators to fulfill all duties associated with property surveys in accordance with established criteria. We also recommended that DLA Manual 8135.1, "Property Administration Manual for Contract Administration Services," December 1986, be revised to provide a requirement that DCAS property administrators verify that contractors reconcile required reports of GFP in their custody with their property control systems (page 11).

The audit identified material internal control weaknesses as defined by Public Law 97-255, "Federal Managers' Financial Integrity Act," Office of Management and Budget Circular A-123, "Internal Control Systems," and DoD Directive 5010.38, "Internal Management Control Program." Adequate written procedures were not developed and requisite personnel were not assigned by the Agency to provide prompt disposition instructions to contractors for GFP in excess of that needed for contract performance. Also, GFP was placed in storage by the Agency and retained there for up to 19 years. The Agency did not identify the need for retaining this property and did not record the property on accountable records. Recommendations A.1. and A.2. if implemented, will correct these weaknesses. There were no monetary benefits associated with these recommendations. A copy of this report will be provided to the senior official responsible for internal controls within the Agency.

A draft of this report was provided to management on October 20, 1989. Comments on the draft were received from the Director, Defense Nuclear Agency, on January 11, 1990; and from the Director, Defense Logistics Agency, on December 14, 1989. The Agency's comments on the draft of this report conformed to the provisions of DoD Directive 7650.3. The Agency Director concurred in Recommendations A.1. through A.3. and no unresolved issues exist on the recommendations or internal control weaknesses. Accordingly, additional comments from the Agency on this final report are not required.

The Director, DLA, concurred in Recommendation B.2., partially concurred in Recommendations B.1.a. and B.1.b., and nonconcurred in Recommendation B.1.c. The initiatives and corrective actions taken by the Director, DLA, in revising property

administration procedures in response to Recommendation B.2. are commendable and should result in significant improvements in the control of GFP in the custody of contractors. Regarding Recommendations B.1.a. and B.1.b., the Director, DLA, indicated that since DLA Manual 8135.1 is being revised to provide additional guidance to property administrators, it is unnecessary to direct property administrators to perform their assigned duties. For the reasons stated in Part II of this report, we maintain that more intensified direction from executive level management and improved oversight by DLA would assist in eliminating property survey deficiencies. Therefore, we believe that Recommendations B.1.a. and B.1.b. are still warranted and request that the Director, DLA, reconsider his position in responding to this final report.

Regarding Recommendation B.1.c., the Director, DLA, stated that when performing property surveys, the lot size for statistical analysis is determined by sampling those transactions that have occurred during the 90 days immediately preceding the date of the sampling. If no transactions have taken place during the 90 days, the samples are taken from transactions going back to the previous property survey. The Director, DLA, also indicated that under revised DoD FAR Supplement 3, which is awaiting approval, property administrators may sample for analysis those transactions that have occurred during a time frame of 90, 180, or 270 days; or since the last survey, if an insufficient number of transactions have occurred to obtain a reasonable sample size for analysis.

Either approach envisions a restrictive sampling plan that would not cover all transaction activity since the last property survey and would produce a statistically biased estimate. These statistical sampling concepts could result in skewed projections and erroneous conclusions regarding the adequacy of contractor controls over GFP. For these reasons and for the reasons contained in Part II of this report, we believe that Recommendation B.1.c. is still warranted. Therefore, we request that the Director, DLA, reconsider his position regarding the time span that a property survey statistical sample should cover in responding to the final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of the final report. Accordingly, final comments on the unresolved issues in this report should be provided within 60 days of the date of this memorandum.

The cooperation and courtesies extended to our audit staff are appreciated. A list of audit team members is in Appendix J. If you have any questions concerning the audit, please call Mr. John A. Gannon on (202) 693-0113 or Mr. Charles M. Hanshaw on (202) 693-0115. Copies of this final report will be distributed to the activities listed in Appendix K.

Stephen A. Trodden
Assistant Inspector General
for Auditing

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force

GOVERNMENT-FURNISHED PROPERTY ADMINISTRATION AT THE DEFENSE NUCLEAR AGENCY

TABLE OF CONTENTS

	Page
TRANSMITTAL MEMORANDUM/EXECUTIVE SUMMARY	i
PART I - INTRODUCTION	
Background	1
Objectives and Scope	2
Prior Audit Coverage	3
PART II - FINDINGS AND RECOMMENDATIONS	5
A. Government-Furnished Property Excess to Contractual Requirements	5
B. Administration of Government-Furnished Property	11
APPENDIX A - Delays Experienced by Contractors in Receiving Plant Clearance Instructions	21
APPENDIX B - Insufficient Surveys at Selected Defense Nuclear Agency Contractors	23
APPENDIX C - Contractor Government-Furnished Property Control Weaknesses	25
APPENDIX D - Summary of the Cost of Government-Furnished Property Understated in the DoD Contract Property Management System	27
APPENDIX E - Summary of Government-Furnished Property Costs Overstated in the DoD Contract Property Management System	29
APPENDIX F - Defense Nuclear Agency Comments	31
APPENDIX G - Defense Logistics Agency Comments	35
APPENDIX H - Summary of Potential Monetary and other Benefits Resulting From Audit	41
APPENDIX I - Activities Visited or Contacted	43
APPENDIX J - Audit Team Members	45
APPENDIX K - Final Report Distribution	47

Prepared by:
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Project No. 8IC-0065

GOVERNMENT-FURNISHED PROPERTY ADMINISTRATION AT THE DEFENSE NUCLEAR AGENCY

PART I - INTRODUCTION

Background

The Defense Nuclear Agency (the Agency) conducts nuclear research in coordination with other DoD Components and Federal agencies to develop technologies and techniques to improve the security and survivability of nuclear weapon systems. The research is performed by contractors who use the Agency's Government-Furnished Property (GFP) for contract performance. As of September 30, 1987, the Agency provided GFP costing about $94 million to 52 contractors.

The DoD and the Congress have taken initiatives to reduce the amount of GFP in the custody of contractors. These initiatives required that contractors must provide all property necessary for performance under Government contracts. However, there are exceptions to this requirement when it is determined to be in the best interest of the Government to provide the property.

Uniform policies and procedures for GFP in the custody of contractors are contained in Federal Acquisition Regulation (FAR), Part 45, and the DoD FAR Supplement. The provisions address the requirements associated with the acquisition, control, reporting, screening, plant clearance, and administration of GFP provided to contractors for performance under Government contracts. Plant clearance is the screening of excess GFP in the custody of contractors for redistribution or disposal. As part of the terms of their contracts, contractors are required to establish property control systems designed to account for and report the GFP to the DoD Contract Property Management System. The report, "DoD Property in the Custody of Contractors," identifies, by contract, all DoD property for which contractors are accountable. The report data in the DoD Contract Property Management System is used by the Defense Logistics Agency (DLA) to prepare management reports for use by DoD Components and the Congress in making policy decisions related to GFP provided to contractors.

DoD property administrators are required to perform surveys of contractor property control systems at least annually to verify the existence of such systems, to ensure that systems meet contractual requirements, and to ensure that contractors have maintained adequate control over GFP. Property administrators are required to report noted deficiencies to contractors for prompt corrective action. If contractors do not take the corrective action and do not maintain effective control systems,

the DoD may disapprove the systems and, thereby, hold contractors liable for future losses of GFP. The Agency had delegated property administration responsibilities for contracts that we reviewed in this audit to Defense Contract Administration Services (DCAS) organizations. However, plant clearance of GFP was performed by the Agency. Implementing instructions for DCAS property administration are in DLA Manual 8135.1, "Property Administration Manual for Contract Administration Services," December 1986. The instructions require that contractor property control systems be reviewed and certified as meeting the accounting control requirements contained in contracts. The instructions also require property surveys at least annually to administer the terms of contracts that specify the contractors' obligation to acquire, to use, to care for, and to dispose of GFP and to evaluate the efficiency of managing GFP.

Objectives and Scope

The overall audit objective was to determine if GFP provided by the Agency to contractors and other users was controlled and administered in accordance with DoD policy, guidance, and procedures. Specific audit objectives were to determine the effectiveness of measures:

- to limit the amount of GFP in the hands of contractors,

- to encourage private sector investment and financing,

- to improve reporting procedures,

- to improve property management functions with particular emphasis on accountability and disposition of GFP, and

- to implement recommendations in Office of the Assistant Inspector General for Auditing, DoD, Report No. 83-107, "Management of Research, Development, Test and Evaluation Capital Equipment, Defense Nuclear Agency," April 21, 1983.

As of September 30, 1987, the Agency provided GFP costing about $94 million to 52 contractors. We audited about $81 million of the GFP in the custody of 11 of the contractors. We reviewed the contract requirements for controlling and reporting GFP. We verified the accuracy and completeness of property accountability records, verified the accuracy of FY 1987 and FY 1988 prescribed reports of Agency GFP in the custody of contractors, and the accuracy of Agency GFP costs recorded in the DoD Contract Property Management System. We reviewed documentation that contained contractor requests for instructions on the disposition of excess GFP; interviewed contractor personnel on the need for retaining GFP, and interviewed Agency personnel on measures taken

to limit the amount of GFP in the custody of contractors and to encourage private sector investment in and financing of GFP. We also reviewed property administration oversight provided by DCAS.

This economy and efficiency audit was made from August 1988 to June 1989 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly, included such tests of internal controls as were considered necessary. Activities visited or contacted during the audit are listed in Appendix I.

Prior Audit Coverage

Our Audit Report No. 83-107, "Management of Research, Development, Test and Evaluation Capital Equipment, Defense Nuclear Agency," April 21, 1983, disclosed that the Agency's capital equipment provided to contractors was excess to contractual requirements, and that the Agency's accountability system provided duplicate property controls. As a result of that audit report, the Agency took corrective actions on all recommendations.

PART II - FINDINGS AND RECOMMENDATIONS

A. Government-Furnished Property Excess to Contractual Requirements

FINDING

The Defense Nuclear Agency's (the Agency) plant clearance functions, designed to redistribute or dispose of Government-Furnished Property (GFP) excess to the contractual requirements were not performed effectively or in a timely manner. Further, the plant clearance functions were not in compliance with established DoD policies and requirements. This condition occurred because the Agency did not develop adequate written procedures and controls for plant clearance nor assign enough trained personnel to the tasks. As a result, there were major delays in the removal of almost $7 million of excess GFP from the custody of Agency contractors. To illustrate, $5.3 million of excess GFP was left in the custody of contractors for up to 30 months awaiting disposition instructions. Another $1.2 million of excess GFP was stored in a Government-owned, contractor-operated plant for up to 19 years without the Agency identifying this condition, justifying the need to retain the property, and recording the property in the Agency's accountable property records. Procedural weaknesses governing plant clearance practices and the absence of required records and associated controls to account for excess GFP retained in storage constituted material internal control weaknesses.

DISCUSSION OF DETAILS

Background. The Federal Acquisition Regulation (FAR), Part 45, and the DoD FAR Supplement stipulate the plant clearance requirements for GFP excess to contractual requirements. These regulations require contractors to promptly prepare and present inventory schedules of excess GFP to the Government plant clearance officer when contract performance is complete or when there is no longer a need to retain the GFP for contract performance. Screening of GFP for plant clearance must begin when acceptable inventory schedules of excess GFP are received from contractors and must be completed within 30 days. During the process, the plant clearance officer may direct that the property be reutilized in performance of other contracts, sold by the contractor, or transferred to DoD property disposal facilities. A primary objective of prompt plant clearance is to prevent the Government from unnecessarily purchasing property already in its inventory, thereby precluding a waste of funds.

DoD Manual 7220.9-M, "Department of Defense Accounting Manual," October 1983, prescribes the standards required for efficient and

effective management of property by DoD Components. DoD Components are required to establish procedures for accountability and control of the property; to enter the property on accountable property records; and to safeguard the property from loss, unauthorized use, and misappropriation. Property excess to specific needs of DoD Components must be disposed of.

Excess Property. Plant clearance functions employed by the Agency to redistribute or dispose of GFP no longer needed for contract performance resulted in significant amounts of property left in the custody of contractors and in storage for inordinate periods. Property costing almost $5.3 million was not redistributed, used elsewhere, or disposed of, primarily because of delays in receiving plant clearance instructions from the Agency. Another $1.2 million of excess property was consigned to storage because of a procedural breakdown in property accounting functions. Associated problems in recordkeeping, development and implementation of appropriate controls, and in the assignment of sufficient personnel to perform these tasks contributed to these conditions.

Excess GFP in the Custody of Contractors. Procedures were not established for the implementation of DoD requirements to promptly screen inventory schedules and to provide plant clearance instructions to contractors in a timely manner. Plant clearance instructions should have been received by contractors within 30 days after they submitted inventory schedules of excess GFP to the Agency. However, contractors experienced major delays in the receipt of plant clearance instructions from the Agency. Plant clearance instructions were delayed from 2 to 30 months after requests were submitted. At two of the five contractors reviewed, plant clearance instructions requested 22 and 25 months prior to June 1989 (the end of our audit cutoff period) were not provided. As a result of these delays, about $5.3 million of excess GFP was left in the custody of contractors for up to 30 months before the Agency provided plant clearance instructions. Additional details concerning delays in providing plant clearance instructions are contained in Appendix A.

Not all plant clearance delays were attributable to the Agency. For example, about $161,000 of other excess GFP was retained by two contractors who did not request plant clearance instructions from the Agency. About $136,000 of this GFP had been on loan to the Agency from the Air Force for about 10 years. Because instructions were not requested, the Agency did not return the property to the Air Force. As a result, the Agency incurred additional, undetermined costs associated with the contractor's management of the property, and the Air Force was precluded from disposing of the property or using it in other research activities.

Excess GFP in Storage. Before excess GFP is consigned to storage, management is required to determine that a valid future need exists, and the property is required to be recorded in the Agency's accountable property records. However, these requirements were not followed. As a result, about $1.2 million of excess GFP was stored in an Agency facility operated by a contractor. The property, consisting of test equipment, power supplies, and other equipment used in nuclear research was accumulated over a 19-year period. Certain excess GFP items remained in storage so long that technological advances rendered these items obsolete.

Because the property was not recorded in the Agency's property records, as required by the DoD Accounting Manual and because no written procedures govern the management of excess property in storage, the property could have been inappropriately used in commercial applications or could have been misappropriated without the Agency's detection.

Cost Impact. Although we found no instances of duplicative procurement of GFP that was already in an excess position, we attempted to determine the cost impact of retaining excess GFP for long periods. One Agency contractor estimated it would cost $736,000 to manage about $1.2 million of excess GFP for 3-1/2 years. Using that contractor's estimate, we calculated that it could cost the Agency more than $929,000 annually to manage the $5.3 million of excess GFP provided the estimated costs are common among Agency contractors. We discussed the cost impact with Defense Contract Audit Agency (DCAA) and Defense Nuclear Agency personnel. Without considerable effort, neither DCAA nor Agency personnel could establish precisely what additional costs were incurred or paid that were directly attributable to contractors retaining excess GFP. Yet, Agency managers clearly recognized that such costs were chargeable as indirect expenses, normally part of an overhead cost element, and were probably paid. These indirect expenses, including maintaining accountability records, performing periodic inventories, and submitting required reports, could have been reduced or avoided if the Agency provided disposition instructions within the specified 30-day period.

Personnel Resource Constraints. Plant clearance delays resulted primarily from the Agency's practice of performing screening functions with in-house personnel. The Agency performed functions normally done by the Defense Contract Administration Services (DCAS). However, the Agency did not assign sufficient nor adequately trained personnel to plant clearance duties. Additionally, personnel assigned to screen GFP had other duties and responsibilities that detracted from or

diverted their efforts. Unless the Agency can provide the needed personnel for plant clearance functions, the Agency should delegate these functions to the DCAS.

Management Actions. Throughout the audit we alerted Agency managers of the deficiencies described above, and they promptly took corrective actions. For example, the $1.2 million of excess GFP in storage was disposed of or reutilized. A senior property manager was assigned to make decisions on excess GFP. Written procedures that prescribe duties and responsibilities associated with GFP were drafted and were in the process of being implemented. Moreover, the Agency agreed to delegate plant clearance functions to DCAS for future contracts providing GFP. When these improvements are fully implemented, the time required for issuing disposition instructions for GFP will be shortened, costs of controlling property will be reduced, and the GFP will be better safeguarded from loss, unauthorized use, misappropriation, and obsolescence.

Internal Management Control. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, guides DoD Components in establishing internal control programs. DoD Components are required to implement a comprehensive program of internal management controls to provide reasonable assurance that assets are safeguarded against waste, loss, unauthorized use, and misappropriation. An internal control program should also prevent mismanagement and correct specific weaknesses in a timely manner. The Directive specifies procedures for identifying and reporting material weaknesses in management controls. The Directive defines a material weakness as a condition in which management controls do not provide reasonable assurance that the internal management control program objectives are being met and as a condition that requires the attention of the next higher level of management. A specific example included in the definition of a material weakness is a condition that significantly weakens safeguards against fraud, waste, or mismanagement of property.

The absence of written controls and procedures governing the prompt screening of Agency provided GFP, and the absence of records for excess GFP placed in storage resulted in weakened safeguards to prevent undetected loss, misappropriation, or unauthorized use. These factors constituted material internal control weaknesses as defined in the Directive. Accordingly, the Agency should report these deficiencies in the annual assurance statement to the Secretary of Defense and track the status of corrective actions taken until assured that problems in control over excess GFP used in nuclear research activities no longer exist.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, Defense Nuclear Agency:

1. Delegate plant clearance duties for future contracts to the Defense Contract Administration Services and examine and evaluate existing contracts to determine if plant clearance duties on those contracts can also be delegated.

2. Develop and implement accountability and control procedures for Government-Furnished Property not assigned on contracts, and for reutilizing and redistributing property no longer needed for contract performance.

3. Report the procedural weakness governing plant clearance practices for Government-Furnished Property in the custody of contractors, and the absence of required records and associated controls over Government-Furnished Property in storage, as material internal control weaknesses to the Secretary of Defense in accordance with DoD Directive 5010.38, "Internal Management Control Program," and track the status of corrective actions taken to improve controls until the problems identified are resolved.

MANAGEMENT COMMENTS

The Director, Defense Nuclear Agency, concurred in the finding and recommendations. The complete text of management comments is in Appendix F.

In response to Recommendation A.1., the Director stated that plant clearance duties for all contracts awarded after May 12, 1989, have been delegated to the DCAS. The Director also stated that all other existing contracts (awarded before May 12, 1989) are being evaluated to determine whether plant clearance functions should be delegated to DCAS. When functions are delegated, administrative modification to every active contract will be necessary. The estimated date for completing this action is March 1990.

Regarding Recommendation A.2., the Director stated that accountability and control procedures for GFP not assigned on contracts will be addressed in a new, comprehensive, Agency instruction on property accountability to be published in January 1990.

In response to Recommendation A.3., the Director stated that based on initial discussions with the auditors, the procedural weaknesses governing plant clearance practices and the absence of required records and associated controls over GFP in storage were

reported as material internal control weaknesses in the Agency's FY 1989 Annual Statement of Assurance to the Secretary of Defense. The Director also stated that the Internal Management Control Program procedures will track the weaknesses until they are corrected.

B. Administration of Government-Furnished Property

FINDING

The Defense Logistics Agency (DLA) did not fully comply with established requirements regarding the management, control, and reporting of Government-Furnished Property (GFP) in the custody of eight contractors engaged in nuclear research. This occurred because oversight and administration practices employed by Defense Contract Administration Services (DCAS) property administrators were not sufficient to detect weaknesses and deficiencies in contractor property control systems and errors in prescribed reports. As a result, loss, unauthorized use, or misappropriation of GFP could occur without detection. Moreover, the DoD Contract Property Management System did not contain sufficient controls to detect errors or omissions in reported costs of GFP. Consequently, these reported costs were misstated by almost $57 million (about $54 million was understated, and about $3 million was overstated) in the system.

DISCUSSION OF DETAILS

Background. Contractors with GFP in their custody are required by Federal Acquisition Regulation (FAR), Part 45, and the DoD FAR Supplement to maintain the official records of GFP and to establish and maintain systems that control, protect, and preserve GFP. Contractors are required to design and maintain property control systems that provide complete, current, and auditable records of all GFP transactions and provide the status of GFP at any stage of contract performance. The property control systems must also be designed to provide accurate and complete reports, by contract, of the total quantity and total acquisition cost of GFP in the custody of contactors at the end of each fiscal year. Information from these prescribed reports is recorded in the DoD Contract Property Management System, which is maintained by the DLA. This information is used by the DLA to prepare management reports for use by DoD managers and the Congress in prescribing policy regarding GFP in the custody of contactors.

Administration of GFP in the custody of the contractors whose property control systems we reviewed was delegated to the DCAS. The Defense Nuclear Agency performed plant clearance duties, which included screening excess GFP for redistribution or disposal. Uniform policies and procedures for GFP administration are contained in the DoD FAR Supplement and DLA Manual 8135.1. These policies and procedures require that contactor property control systems be surveyed at the time contracts with GFP provisions are initially awarded, and annually thereafter, to verify that contractors have established systems with adequate

controls to achieve compliance with the GFP requirements in FAR, Part 45. Surveys of property control systems include tests to verify that contractors are safeguarding GFP from loss, unauthorized use, and misappropriation and are accurately recording and reporting all GFP in their custody. If controls are found to be inadequate, property control systems may be disapproved and the contractors held liable for future losses of GFP.

Property Administration. DCAS property administrators did not perform property surveys in full accordance with procedures contained in the DoD FAR Supplement and the DLA Manual. Consequently, contractor property control systems contained weaknesses and deficiencies that led to errors in prescribed reports and the misstatement of GFP costs in the DoD Contract Property Management System.

Property Surveys. Property control systems maintained by 7 of the 11 contractors included in our audit were not sufficiently surveyed by DCAS property administrators to ensure that property was properly controlled, recorded, and reported. For example, as shown in Appendix B, property control systems maintained by contractors frequently were not surveyed annually as required. Prescribed reports submitted by contractors frequently were not reviewed by DCAS property administrators to ensure that the reports were accurate, complete, and reconcilable to property control systems. DCAS property administrators frequently did not verify the existence of recorded property during surveys of property control systems maintained by contractors, and did not verify that property in use in contractors' facilities was recorded in property control records. A manager of one DCAS region told us that verification of GFP in inventory to property control records was not made because verification was not required. However, verification is specifically required not only by the DoD FAR Supplement, but also by DLA Manual 8135.1. Both contain detailed instructions for DCAS property administrators when conducting property surveys. The lack of sufficient property administration oversight and surveys led to undetected contractor property control system weaknesses that contributed to unrecorded and unreported GFP in the custody of contractors.

Contractor Property Control Systems. In addition to the problems discussed above regarding property surveys, we found that significant problems existed in contractor property control systems. For example, one contractor had $36 million of GFP, provided by the Agency, recorded in an automated property control system that was not approved by the DCAS property administrator. Rather, the property administrator approved a manual property control system and related procedures. The automated property

system in use lacked written controls and had no procedures for recording and reporting GFP as required. The contractor used a barcoding system to establish a property record in the automated property control system by scanning the identification tag attached to the GFP. If a barcode identification tag could not be attached to the GFP, the GFP was not recorded in the property control system and was not reported as required. For example, we found that barcode identification tags were not attached to Government-furnished computer components valued at about $211,000. These components were neither recorded in the property control system nor reported in prescribed reports. These conditions went undetected for more than 1 year because the DCAS property administrator did not verify that GFP existed and that prescribed reports were reconciled with the property control system. The contractor's property manager told us that he assumed that the GFP did not have to be reported because it was assigned to a Government-owned, contractor-operated plant. Consequently, the $36 million of GFP was not reported as required in the DoD Contract Property Management System.

Another contractor reported GFP with an acquisition cost of about $2 million for three completed contracts. The GFP assigned on the contracts was still in the custody of the contractor, but the GFP control records were deleted from the property control system when the contracts were completed. The contractor's property control procedures did not require that physical inventories of GFP be reconciled to official property control records or that variances be accounted for between physical inventory balances and recorded balances. Also, the contractor's GFP control records did not contain adequate documentation to support the acquisition, transfer, or disposal of GFP. Further, the contractor's GFP control system did not contain a sufficient audit trail to allow for reconciliation of GFP control records to prescribed reports. Therefore, the accuracy of information relating to the GFP in the contractor's custody could not be verified. These conditions existed because the property administrator did not survey the property control system in FY 1988 nor verify GFP on hand during surveys performed in FY 1986 and FY 1987.

Prescribed Property Reports. Each contractor is required to prepare an annual report titled, "Report of DoD Property in the Custody of Contractors." This report contains a list of GFP, by category, and the acquisition cost of the property. This report, extracted from the contractor's property control system, is submitted to the DCAS property administrator for review and approval. The property administrator transmits reported information to the DoD Contract Property Management System. We found that some reports were not filed with the property administrator and other reports contained errors. The

problems with prescribed reports were attributable to weaknesses in property control systems, as detailed in Appendix C. For example, one contractor maintained a property control system that did not meet the requirements in the FAR, Part 45, and the DoD FAR Supplement because the system was not designed to generate accurate prescribed reports. The prescribed reports were prepared from summary financial information in the contractor's general ledger. The reported information was not reconcilable to detailed information recorded in the property control system and records. Consequently, the accuracy of information on this contractor's GFP could not be verified. This condition was not detected by the property administrator during the property survey performed in FY 1987. A property survey was not performed in FY 1988.

DoD Contract Property Management System. Problems noted in property administration, particularly inadequate surveys, nonperformance of surveys, and weaknesses in contractor property control systems resulted in serious misstatements of the costs of GFP in the custody of contractors and in the DoD Contract Property Management System. We found errors totaling almost $57 million ($54 million in understated costs and $3 million in overstated costs).

Understated Costs. About $54 million of GFP was understated in the DoD Contract Property Management System, as detailed in Appendix D. Of the $54 million, about $36.4 million of GFP was not reported, as discussed previously, because a contractor assumed that GFP in a Government-owned, contractor-operated plant did not have to be reported to the DoD. In addition, the property administrator did not verify that the GFP control records and prescribed reports were accurate and complete. Another $17 million of GFP was not reported because property administrators did not transmit accurate and complete information from contractors' prescribed reports and did not verify that the information recorded in the DoD Contract Property Management System was correct.

Overstated Costs. Recorded acquisition costs of GFP were overstated by about $3 million (see Appendix E). About $2.1 million was overstated because the same information was transmitted twice by property administrators to the DoD Contract Property Management System. Another $780,000 was overstated because incorrect information was transmitted, and about $97,000 was overstated because contractors submitted unverified information to property administrators. These errors could have been found if DCAS property administrators checked the accuracy of information in the prescribed reports and in the DoD Contract Property Management System.

During our audit, the DLA implemented internal controls in the DoD Contract Property Management System to detect report errors and omissions and planned to continue improving the system. Therefore, no recommendation is made at this time to correct the problems noted in the DoD Contract Property Management System.

Conclusion. The requirements established in FAR, Part 45, and the DoD FAR Supplement for controlling and reporting GFP in the custody of contractors were not effectively implemented. Weaknesses and discrepancies in contractor GFP control systems and records resulted in the erosion of safeguards designed to prevent undetected loss, unauthorized use, and misappropriation of GFP provided to contractors. These weaknesses and discrepancies contributed to inaccurate and incomplete information on the acquisition cost of GFP reported to and recorded in the DoD Contract Property Management System. Information from the DoD Contract Property Management System provided to DoD managers and the Congress for use in prescribing policies regarding GFP was inaccurate, and could have led to uninformed decisions by policymakers.

Defense Contract Administration Services property administrators should conform to the requirements in the FAR and the DoD FAR Supplement, as well as those in DLA Manual 8135.1. Further, the property administrators should improve their verification practices to ensure that accurate information on GFP is transmitted to and recorded in the DoD Contract Property Management System.

Although this report discusses weaknesses and deficiencies in the administration of GFP only at the Defense Nuclear Agency, it is our opinion that similar weaknesses and deficiencies are prevalent DoD-wide. Property administrators responsible for administering GFP on these contracts were also responsible for administering GFP on contracts performed for other DoD Components. Further, the DoD Contract Property Management System is a repository for all prescribed reports of DoD GFP in the custody of contractors. Therefore, the integrity of data recorded in this system is of paramount importance.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, Defense Logistics Agency:

1. Direct the Defense Contract Administration Services property administrators to perform all duties associated with property surveys in accordance with established criteria. These property surveys should, at a minimum, include steps:

a. To detect property control systems that do not have all Government-Furnished Property recorded and do not provide complete, current, and auditable transaction records.

b. To verify that contractors have reconciled data in prescribed reports with data recorded in property control systems and that contractors have submitted prompt and accurate reports of Government-Furnished Property in their custody.

c. To provide property survey coverage for entire periods dating back to the cutoff date of prior surveys.

2. Revise Defense Logistics Agency Manual 8135.1, "Property Administration Manual for Contract Administration Services," December 1986, to require property administrators to verify that contractors have reconciled prescribed reports to property control systems.

MANAGEMENT COMMENTS

The Director, Defense Logistics Agency, concurred in the finding and in Recommendation B.2., partially concurred in Recommendations B.1.a. and B.1.b., and nonconcurred in Recommendation B.1.c. The complete text of the Director's comments is in Appendix G.

Regarding Recommendation B.2., the Director stated that by February 1, 1990, DLA Manual 8135.1 will be amended to add a requirement for property administrators to check the balances on the prescribed reports against balances on the official property records in order to detect possible errors or omissions.

The Director partially concurred in Recommendation B.1.a. and stated that DLA Manual 8135.1 will be revised by February 1, 1990, to reinforce existing guidance for performing the property records verification portion of a property survey. This action will aid efforts to detect property control systems that do not have all Government-Furnished Property recorded and will ensure that complete transaction records are maintained by the contractor. The Director did not agree that property administrators needed to be directed to perform their assigned duties.

In responding to Recommendation B.1.b., the Director partially concurred and stated that additional guidance in reconciling reports and property records is being included in the revision of DLA Manual 8135.1, which is scheduled for completion by February 1, 1990. The guidance should remedy the incidents we identified. Regarding the accuracy of reports, the Director stated that property administrators are reminded each year to

ensure that required data were not omitted and that significant discrepancies in reported property data are to be investigated and resolved. The Director stated that isolated instances of contractors not reconciling property records with reports do not warrant further direction to property administrators to perform their duties.

The Director nonconcurred with Recommendation B.1.c. and stated that the DoD FAR Supplement S3-402 specifies the lot size for statistical analysis by sampling transactions, except for disposition transactions that have occurred during the 90 days immediately preceding the date of the sampling. If no transactions have taken place during that 90-day period, the samples will be taken from transactions going back to the previous system survey. This 90-day time frame is a DoD FAR Supplement requirement and not a DLA requirement. Therefore, any proposed revision of the statistical sampling concept is outside the purview of the DLA. The Director stated that in 1988, a DoD task group was established to rewrite DoD FAR Supplement 3. The proposed revision is in the Office of the Assistant Secretary of Defense (Production and Logistics) for review. Under the proposed revision, the property administrator may sample for statistical analysis any transactions that have occurred during the preceding 90, 180, or 270 days, or if insufficient transactions have occurred to obtain a reasonable population for analysis, the property administrator may sample transactions occurring since the last survey. Last, the Director stated that stratifying the population statistically provides the same degree of reliability and validity whether transactions are sampled from the preceding 90 days or from 1 year.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The comments from the Director, Defense Logistics Agency, in response to Recommendation B.2. fully complied with the requirements of DoD Directive 7650.3. Planned revisions to DLA Manual 8135.1 are commendable initiatives that, when implemented, will institute a needed reconciliation process and improve controls and will result in accurate data being reported to DLA.

Concerning Recommendations B.1.a. and B.1.b., the Director partially concurred. Although the proposed corrective actions regarding property survey deficiencies are positive steps that will improve the process, they will not provide full safeguarding of GFP. As discussed in Finding B., property administrators did not, by DLA written standards, effectively administer about $69 million of Government property in the custody of contractors. Using criteria in DLA Manual 8135.1, we found 23 significant weaknesses in 5 contractor property control systems that should

have been detected by administrators from 5 Defense Contract Administration Services Management Area offices. (See Appendix C for details). Further, these property survey weaknesses contributed directly to misstatements of costs totaling about $57 million reported to and recorded in the DLA managed DoD Contract Property Management System. The conditions disclosed by the audit are not isolated cases. Rather, they indicate a widespread trend. The conditions occurred despite DLA's written guidance to property administrators. In many instances, property administrators were not doing their jobs properly.

DLA's position that further direction is not needed because written directions are in the Manual ignores the root cause of the deficiencies. During the audit, we repeatedly found situations in which property administrators did not comply with written directions. Therefore, without additional top management direction, DLA has no assurance that property administrators will comply with written guidance in the future. Hence, we maintain that DLA should direct property administrators to perform all duties associated with property surveys. Accordingly, we request that the Director reconsider his position on these recommendations in response to this final report.

We question DLA's response to Recommendation B.1.c. As discussed in Finding B, and detailed in Appendix B, our review of GFP provided to 7 contractors under 12 contracts disclosed 15 instances of deficiencies in property surveys. Of the 15 instances detected, 6 instances consisted of conditions where GFP was not surveyed annually as required. Although we fully recognize the pressure DLA faces regarding work load versus limited staff, the need to provide coverage for entire periods between surveys becomes even more crucial when property surveys are not performed annually. Periods between surveys that exceed a year increase the Government's risk that GFP could be lost or diverted to other than intended uses. This risk can be reduced or eliminated by expanding the sampling plan to cover the entire period between surveys. Limiting the sampling of GFP transactions to the most recent 90-day period could prevent the detection of problems in a contractor's property control system.

Under the proposed revision to the DoD FAR Supplement, property administrators may extend the period of coverage from the date of the current survey to the preceding 90, 180, or 270 days, or to the date of the last survey if insufficient transactions have occurred to obtain a reasonable population for analysis. However, under the proposed revision to the Supplement, DLA will not extend coverage beyond the most recent 90 days if there are enough transactions to constitute a universe for that period. The DLA position on this sampling approach is based on the fact

that the 90-day sampling period is a DoD not a DLA requirement, and that this sampling approach provides the same degree of reliability and validity whether transactions are sampled from the preceding 90 days or from 1 year. The 90-day requirement could be easily adjusted by a DLA proposal to change the revised DoD FAR Supplement under review.

A greater problem lies with the sampling methodology. Use of statistical sampling for estimation purposes requires that items in the sample be taken from the entire universe; that is, each item in the universe must have an equal chance of being selected for inclusion in the sample. This method is imperative when attempting to sample cyclical data such as that used by DLA property administrators. Selecting a sample from the preceding 90-day period is not acceptable for estimation because of the nonhomogeneous numbers or sizes of transactions across time. The contention that the same degree of reliability and validity is provided whether transactions are sampled from the preceding 90 days or from 1 year is just not statistically true. For a sample test to be valid, each property item must have an equal chance of being selected for review. Further, because of natural fluctuation patterns in property transactions, it cannot be assumed that any 90-day period is representative of another 90-day period. Any attempt to use one 90-day period to represent the entire year or set of years since the last survey will produce a biased estimate that cannot be measured within the context of a sampling error. This statistical bias, which in this case is due to seasonality, is called a nonsampling error. Statistical bias can be measured only by sampling from various time frames and by demonstrating fluctuation. Applying the DLA statistical sampling concept could yield invalid statistical results, skewed projections, and ultimately erroneous conclusions concerning the adequacy of contractors' controls over GFP. This predicament can be avoided by sampling transactions from all the time periods dating from the cutoff date of the prior survey to the date of the current survey. Accordingly, we maintain that our recommendation is still valid, and we request that the Director reconsider his position on this recommendation in response to this final audit report.

DELAYS EXPERIENCED BY CONTRACTORS IN RECEIVING PLANT CLEARANCE INSTRUCTIONS

Contractor	Acquisition Cost of GFP 1/ Awaiting Plant Clearance	Date Plant Clearance 2/ Instructions Requested	Date Plant Clearance Instructions Received	Total Delay (Months)
BDM Corporation	$1,293,553	July 1987	August 1988	13
	401,488	November 1987	Not received	19 3/
Bendix Field Engineering Corporation	3,273,269	April 1985	October 1987	30
Jaycor Corporation	43,772	August 1987	Not received	22 3/
Mission Research	113,773	May 1987	Not received	25 3/
S-Cubed, A Division of Maxwell Labs, Inc.	50,414	September 1987	November 1988	14
	450	January 1988	November 1988	10
	141,494	January 1988	November 1988	2
TOTAL	$5,318,213			

1/ Government-Furnished Property.
2/ Plant Clearance is the screening of Government-Furnished Property excess to contractual requirements for redistribution or disposal.
3/ Total delay as of June 9, 1989, the cutoff date of our audit field work.

INSUFFICIENT SURVEYS AT SELECTED DEFENSE NUCLEAR AGENCY CONTRACTORS

Cognizant Property Administration Office	Contractor	Contractor Number	Acquisition Cost of Property	Instances of Insufficient Government-Furnished Property Surveys
DCASMA, Santa Ana, CA *	Bendix Field Engineering Corp.	DNA001-88-C-0035	$36,105,485	Property surveys were made without property verification and without review of required annual reports for FY 1986, FY 1987, and FY 1988.
DCASMA, San Francisco, CA	Physics International	DNA001-85-E-0143	13,996,321	Property survey was not made for FY 1988.
DCASMA, Phoenix, AZ	BDM Corporation	DNA001-85-C-0282 DNA001-86-C-0110 DNA001-86-C-0281 DNA001-85-C-0390	6,926,698 1,510,843 763,729 26,533	Property survey was not made for FY 1987.
DCASMA, San Francisco, CA	SRI International	DNA001-87-E-0130 DNA001-84-C-0065	3,846,699 140,068	Property surveys were not made for FY 1986 and FY 1988.
DCASMA, El Segundo, CA	R & D Associates	DNA001-84-C-0041 DNA001-83-C-0153	1,521,858 1,128,400	Property survey was not made for FY 1988; Property surveys were made without property verification for FY 1986 and FY 1987.
DCASMA, Phoenix, AZ	EG&G, WASC, Inc.	DNA001-85-C-0308	1,867,083	Property surveys were not made for FY 1987 and FY 1988.
DCASMA, Van Nuys, CA	Mission Research	DNA001-84-E-0031	678,268	Property surveys were made without reviewing the required annual reports for FY 1987 and FY 1988.

* DCASMA is a Defense Contract Administration Services Management Area, a Defense Logistics Agency subordinate activity.

CONTRACTOR GOVERNMENT-FURNISHED PROPERTY CONTROL WEAKNESSES

Type of Weakness	R & D Associates	Bendix Field Engineering Corporation	Physics International	Mission Research	Maxwell Laboratories
Category* 1 - Acquisition					
- Unauthorized purchases.	X				
Category 2 - Receiving					
- Government-Furnished Property (GFP) misclassified.	X				
- GFP not tagged for identification.	X		X		
Category 3 - Records					
- Beginning and ending balances of GFP not reconciled with transactions for the period.	X		X	X	X
- Audit trail lacking or incomplete.	X		X		
- Incorrect costs recorded.	X		X		
- Mathematical accuracy of records not checked.	X			X	
- Unrecorded GFP.	X	X			
- Beginning balances in records did not agree with ending balances of prior period.	X				
Category 10 - Disposition					
- GFP not redistributed or disposed of.	X				
- GFP not reported.		X	X	X	
- Detailed GFP records not in agreement with prescribed reports.	X		X		

* Category is defined in DoD Federal Acquisition Regulation Supplement 3-102.1 as a major segment of a contractor's property control system. There are 10 categories subject to review by DoD property administrators.

SUMMARY OF THE COST OF GOVERNMENT-FURNISHED PROPERTY UNDERSTATED IN THE DOD CONTRACT PROPERTY MANAGEMENT SYSTEM

Contractor	Acquisition Contract Number	Cost	Causes
Fiscal Year 1987			
Bendix Field Engineering Corporation	DNA001-83-C-0023	$36,105,485	1/ 2/
BDM Corporation	DNA001-85-C-0083	500,375	3/
BDM Corporation	DNA001-85-C-0282	6,926,698	3/
BDM Corporation	DNA001-85-C-0390	26,533	3/
BDM Corporation	DNA001-86-C-0110	1,510,843	3/
Maxwell Laboratories	DNA001-84-E-0388	208,341	3/
Maxwell Laboratories	DNA001-86-C-0176	98,428	3/
Mission Research	DNA001-86-C-0048	25,594	2/
Physics International	DNA001-85-E-0143	59,284	2/
Total - FY 1987		$45,461,581	
Fiscal Year 1988			
Bendix Field Engineering Corporation	DNA001-88-C-0035	$ 211,500	1/
BDM Corporation	DNA001-85-C-0282	7,649,248	5/
Mission Research	DNA001-86-C-0048	7,298	4/
Mission Research	DNA001-88-E-0101	501,963	4/
Physics International	DNA001-88-E-0099	43,157	2/ 4/
Total - FY 1988		$ 8,413,166	
Totals - FY 1987 and FY 1988		$53,874,747	

1/ Contractors did not record all accountable Government-Furnished Property (GFP) in their custody.
2/ Contractors did not report all GFP in their custody.
3/ Property administrators did not verify the accuracy of GFP data that they transmitted to the DoD Contract Property Management System.
4/ Contractors did not reconcile prescribed reports with their property control systems.
5/ Property administrators did not transmit prescribed report data to the DoD Contract Property Management System.

SUMMARY OF GOVERNMENT-FURNISHED PROPERTY COSTS OVERSTATED IN THE DOD CONTRACT PROPERTY MANAGEMENT SYSTEM

Contractor	Acquisition Contract Number	Cost	Causes
Fiscal Year 1987			
Arvin Calspan Corp. ATC	DNA001-83-C-0182	202,665	1/
Arvin Calspan Corp. ATC	DNA001-85-C-0129	$ 6,758	1/
BDM Corporation	DNA001-84-C-0437	16,047	2/
BDM Corporation	DNA001-86-C-0281	763,729	2/
Boeing Aerospace Co.	DNA001-82-C-0085	650	1/
Boeing Aerospace Co.	DNA001-84-C-0182	15,000	1/
EG&G WASC, Inc.	DNA001-84-E-0308	1,867,083	1/
Maxwell Laboratories	DNA001-84-E-0358	43,000	3/
Total - FY 1987		$ 2,914,932	
Fiscal Year 1988			
R & D Associates	DNA001-87-C-0071	54,000	3/
Total - FY 1987 and FY 1988		$ 2,968,932	

1/ Government-Furnished Property data recorded twice in the DoD Contract Property Management System.
2/ Property administrators did not verify that data were accurately recorded in the DoD Contract Property Management System.
3/ Contractors did not reconcile prescribed annual reports with their property control systems.

Defense Nuclear Agency
6801 Telegraph Road
Alexandria, Virginia 22310-3398

JAN - 8 1990

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Project No. 81C-0065).

1. Reference your memorandum dated 20 Oct 89, subject as above.

2. The draft audit report provided with the reference has been reviewed. The Agency's responses to your findings and recommendations, and information required by DoD Directive 7650.3, follow:

a. Finding - DNA's plant clearance functions were not performed effectively or in a timely manner and were not in compliance with established DoD Policies and requirements. Adequate written procedures and controls for plant clearance were not developed nor adequate trained personnel assigned to the tasks. These procedural weaknesses constituted material internal control weaknesses.

Agency response - Concur.

b. Recommendations for Corrective Action -

(1) Delegate plant clearance duties for future contracts to the Defense Contract Administration Services and examine and evaluate existing contracts to determine if plant clearance duties on those contracts should also be delegated.

Agency response - Concur.

Agency status - All contracts awarded after 12 May 89 have delegated plant clearance duties to the Defense Contract Administration Services (DCAS). Currently, all other existing contracts (awarded prior to 12 May 89) are being evaluated to determine whether plant clearance functions should be delegated to DCAS. Where delegation will occur, administrative modification to every active contract will be necessary. Our estimated completion date for evaluation of existing contracts is 15 Jan 90; contract modifications would be completed by 15 Mar 90.

SUBJECT: Draft Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Project No. 81C-0065)

(2) Develop and implement accountability and control procedures for Government-Furnished Property not assigned on contracts, and for reutilizing and redistributing property no longer needed for contract performance.

Agency response - Concur.

Agency status - Accountability and control procedures for Government-Furnished Property not assigned on contracts will be addressed in a new, comprehensive, DNA Instruction on Property Accountability. Our estimated date for publication of this Instruction is 20 Jan 90. For your information, property found by the auditors at the ARES Facility has been screened for reutilization and disposed of by DNA's Field Command personnel; property retained has been assigned to the contractor supporting the ARES Facility.

(3) Report the procedural weakness governing plant clearance practices for Government-Furnished Property in the custody of contractors, and the absence of required records and associated controls over Government-Furnished Property in storage, as material internal control weasknesses to the Secretary of Defense in accordance with DoD Directive 5010.38, "Internal Management Control Program," and track the status of corrective actions taken to improve controls until the problems identified are resolved.

Agency response - Concur.

Agency status - Based on initial discussions with the auditors, this weakness was reported in DNA's FY-89 Annual Statement of Assurance to the Secretary of Defense (see attached). This action is considered completed; the weakness has been reported in accordance with DoD Directive 5010.38, and will be followed by Internal Management Control Program procedures until the weakness is corrected.

3. Follow-up on currently incomplete actions being taken in response to recommendations will be accomplished by the Special Activities Division of the Directorate for Plans, Programs and Requirements. Questions may be referred to Mrs. Pope at commercial (703) 325-6978.

Attachment:
as stated

GERALD G. WATSON
Major General, USA
Director

MATERIAL WEAKNESSES IDENTIFIED, BUT NOT CORRECTED, DURING THE PERIOD

PROPERTY ADMINISTRATION OVERSIGHT OF CONTRACTOR GOVERNMENT-FURNISHED PROPERTY (GFP)

1. Functional Category: PROPERTY MANAGEMENT

2. Description: A procedural weakness exists in plant clearance practice for GFP in the custody of contractors, and there is an absence of required records and associated controls over GFP in storage.

3. Potential Consequences: Safeguards to prevent undetected loss, misappropriation or unauthorized use of GFP were weakened. This resulted in inordinate delays of up to 30 months before disposition instructions on GFP were received, and resulted in storage of excess GFP and the incurrence of undeterminable costs.

4. Responsible Officials: DNA Director of Command Services. CAPT W. Straight, USN, (703) 325-7529, and Director of DNA Acquisition Management, Mr. D. Freeman, (703) 325-1183.

5. Source Uncovering the Weakness: DoDIG Audit 81C-0065

6. Milestones:

a. Delegate plant clearance duties to DCAS

b. Publish written procedures for GFP management

c. Establish procedure to provide disposition instructions on GFP within 30 days of request

d. Dispose of excess GFP

e. Expected completion date is 30 October 1990.

7. Information on Corrective Actions:

a. A DoDIG Audit on "Government-Furnished Property Administration at the Defense Nuclear Agency, (8IC-0065)" was conducted from August 1988 to June 1989.

b. It was found that the Agency generally employed good property management practices. For example, effective measures were taken to limit the amount of GFP and to encourage private sector investment in and financing of property used in nuclear research. However, the Agency's plant clearance functions, designed to redistribute or dispose of excess GFP, were not in

compliance with established DoD policies and requirements. The DoDIG recommended that the Agency delegate plant clearance duties to the Defense Contract Administration Services (DCAS), develop and implement procedures for management of GFP not assigned on contracts and for reutilization and distribution of GFP no longer needed for contract performance. It also recommended that the Agency report and track the lack of controls over excess GFP in custody of contractors and in storage as a material weakness.

c. Based on discussions with the DoDIG audit team during the audit about the expected findings and recommendations, steps were taken to institute remedies prior to publication of the report.

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY REFER TO DLA-CI

11 DEC 1989

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Project No. 8IC-0065)

In response to your memorandum dated 20 October 1989, enclosed are our comments to the draft report.

FOR THE DIRECTOR:

Reathea E. Holmes

REATHEA E. HOLMES
Chief, Internal Review Division
Office of Comptroller

3 Encl

TYPE OF REPORT: AUDIT DATE OF POSITION: 11 Dec 89

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Project No. 8IC-0065)

FINDING B: The Defense Logistics Agency (DLA) did not fully comply with established requirements regarding the management, control, and reporting of Government-Furnished Property (GFP) in the custody of eight contractors engaged in nuclear research. This occurred because oversight and administration practices employed by Defense Contract Administration Services (DCAS) property administrators were not sufficient to detect weaknesses and deficiencies in contractor property control systems and errors in prescribed reports. As a result, loss, unauthorized use, or misappropriation of GFP could occur without detection. Moreover, the DoD Contract Property Management System did not contain sufficient controls to detect errors or omissions in reported costs of GFP. Consequently, these reported costs were mis-stated by almost $57 million (about $54 million was understated, and about $3 million was overstated) in the system.

DLA COMMENTS: Concur. In 1986, the Defense Government Property Council, Chaired by the Deputy Assistant Secretary of Defense for Production Support, approved a revised reporting system for Government property in the hands of DoD contractors which has been incorporated into the DFARS. Since this time this reporting system has undergone many revisions and enhancements. The Contract Property Management System (CPMS) has been continually upgraded to increased capacity, adding many built-in edit checks to purify the data base and assure the accuracy of the data. Recent enhancements include the rejection of duplicate contracts, rejection of contracts without a proper Department of Defense Activity Address Code and rejection of contracts with invalid purpose codes or mathematical errors. The revised system doesn't allow the input of contracts without both dollar value and quantity and also checks the previous year's input against the current year to assure contracts are not omitted. These enhancements allow the Property Administrator (PA) to detect possible errors and omissions in the Government property reported annually by each contractor. The CPMS continues to be improved, providing increased visibility over all DoD property, and such improvements should preclude recurrence of the reporting problems cited in the Draft Audit Report.

In accordance with the requirements of the DoD Federal Acquisition Regulation Supplement (DFARS) Number 3 and DLAM 8135.1, Property Administration Manual for Contract Administration, PAs perform a property control system survey at least once each fiscal year to assure protection of the Government's interests through a uniform property administration program. While the Draft Audit Report cites several instances where annual surveys were not performed in the past, property control system surveys were performed in 1989 at these contractors. The system surveillance approach evaluates the contractor's management and control of Government property By using a statistical sampling method, the PA examines the characteristics of the contractor's property control system as outlined in Annex I of DFARS 3 to evaluate and determine the performance level for each functional area and category of the system. This method provides the Government an

acceptable confidence level relative to resource investment. Although the Draft Audit Report does not cite any actual instances, the possibility exists that some losses, unauthorized use, or misappropriation of Government property could occur without detection when one considers that approximately $22 billion of Government property, as reported on the DoD and NASA property reports, is administered by 300 DLA (CAS) PAs at 4500 contractor locations.

MONETARY BENEFITS: None. DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Julia Harman, DLA-AMP, 47607

DLA APPROVAL: William J. Cassell

TYPE OF REPORT: AUDIT DATE OF POSITION: 11 Dec 89

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Project No. 8IC-0065)

RECOMMENDATION B.1: We recommend that the Director, Defense Logistics Agency, direct the Defense Contract Administration Services' property administrators to perform all duties associated with property surveys in accordance with established criteria. These property surveys should, at a minimum, include steps: (a) to detect property control systems that do not have all Government-Furnished Property recorded and do not provide complete, current, and auditable transaction records, (b) to verify that contractors have reconciled data in prescribed reports with data recorded in property control systems and that contractors have submitted prompt and accurate reports of Government-Furnished Property in their custody, and (c) to provide property survey coverage for entire periods dating back to the cutoff date of prior surveys.

DLA COMMENTS: Partially Concur, B.1(a). DoD FAR Supplement 3 and DLAM 8135.1 provide detailed direction to the Property Administrator (PA) regarding performance of all necessary property system surveillance, including both a 'records to property' and 'property to records' verification during the property control system survey, in order to ensure that all Government property has been recorded These regulatory requirements clearly state the PA's responsibilities for performing system surveys and it is therefore unnecessary for the Director, Defense Logistics Agency, to direct Defense Contract Administration Services' PAs to perform their assigned duties. DLAM 8135.1 is currently being revised to reinforce existing guidance for performing the 'property to records' verification. This guidance will specify how to determine the universe/lot size and sample size to perform this verification for both material and equipment in an effort to prevent further occurrences of Government property not being entered into the official property records. This supplementary guidance should help preclude any incidents of property not being properly recorded in the contractor's property control system. In addition, FAR 45.508 requires contractors to perform periodic physical inventories of all Government property and submit a statement to the PA stating date inventory was completed and that the official property records were found to be in agreement except for the discrepancies reported. These inventories must evidence physical counts of selected items without knowledge of record balances, verification of the entries, comparison with the records, and preparation of documents necessary for required adjustments. These adjustment documents must be forwarded to the PA requesting relief of liability/responsibility. The PA investigates the loss to reach a valid and supportable conclusion as to liability under the terms of the contract and the course of action required to conclude the adjustment action.

Partially Concur, B.1(b) DFARS 245.505-14 requires contractors to submit DD Form 1662, DoD Property in the Custody of Contractors, to their PA by 31 October each year. PAs evaluate the contractors' performance in preparing and submitting the DD 1662 during the property system survey as part of the review of the Reports category pursuant to

the guidance in Annex III of DLAM 8135.1. Each year, prior to submission into the CPMS data base, we remind our PAs to review the DD 1662s to ensure there are no omissions of required data. Significant changes in dollar amounts or line items from the previous year's submission that cannot be readily explained should be investigated and resolved. Discrepancies between the previous year's ending balances and beginning balances of the current year's report should also be investigated We have witnessed significant improvements in the CPMS reporting program since its inception in 1986. Isolated incidents of contractors not reconciling property records with reports do not warrant having the Director, Defense Logistics Agency, direct Defense Contract Administration Services' PAs to perform their assigned duties. Instead, additional guidance in reconciling reports and property records is being included in the current revision to the DLAM 8135.1 and is considered an appropriate remedy to the incidents reported in the Draft Audit.

Nonconcur, B.1(c). DFARS S3-402 specifies that in performing the survey, the PA shall determine the lot size for statistical analysis by sampling those transactions, except for disposition transactions, which have occurred during the last 90 days immediately preceding the date of the sampling. If no transactions have taken place during the last 90 days, the samples will be taken from transactions going back to the previous system survey. This 90 day requirement is a DFARS and not a DLA requirement, and therefore, any proposed revision to this timeframe is outside the purview of DLA. In performing the sampling of categories that lend themselves to transactional analysis, such as Acquisition, Receiving, Consumption and Utilization, stratifying the population makes the transactions more manageable and statistically provides the same degree of reliability and validity whether you sample transactions for 90 days or one year. In 1988 a DoD Task Group was established to rewrite DFARS Supplement 3 Currently this revision is in the Office of the Deputy Assistant Secretary of Defense for Logistics for review. Under the revised Supplement 3, the PA may sample those items that lend themselves to transactional analysis which have occurred during a set timeframe of either 90, 180, or 270 days or since the last survey, if insufficient transactions have occurred to obtain a reasonable population for analysis.

DISPOSITION:
(X) Action is ongoing; Final Estimated Completion Date: 1 Feb 1990
( ) Action is considered complete

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Julia Harman, DLA-AMP, 47607

DLA APPROVAL: William J. Cassell

TYPE OF REPORT: AUDIT DATE OF POSITION: 11 Dec 89

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Audit Report on Government-Furnished Property Administration at the Defense Nuclear Agency (Project No. 8IC-0065)

RECOMMENDATION B.2: We recommend that the Director, Defense Logistics Agency, revise Defense Logistics Manual 8135.1, "Property Administration Manual for Contract Administration Services," December 1986, to require property administrators to verify that contractors have reconciled prescribed reports to property control systems.

DLA COMMENTS: Concur. DLAM 8135.1 is currently being revised and Annex III, Category II, Reports, will be amended to add a characteristic requiring the Property Administrator to verify the accuracy and completeness of DD Forms 1662 during the annual property control system survey. This characteristic will require the Property Administrator to check the balances on the DD 1662s against the balances on the official property records to detect possible errors or omissions.

DISPOSITION:
(X) Action is ongoing; Final Estimated Completion Date: 1 Feb 1990.
( ) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Julia Harman, DLA-AMP, 47607

DLA APPROVAL: William J. Cassell

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1., A.2., and A.3	Internal Control. Implementing these recommendations will provide improved internal controls over Government-Furnished Property (GFP) no longer needed for contract performance and eliminate two material internal control weaknesses.	Nonmonetary *
B.1. and B.2.	Economy and Efficiency and Internal Control. Implementing these recommendations will improve the efficiency and effectiveness of property control surveys, strengthen the administration of GFP, and provide better safeguards of GFP in the possession of contractors from undetected loss, unauthorized use, or misappropriation.	Nonmonetary *

* There were no monetary benefits associated with these recommendations. No instances were disclosed of procurement of GFP already in inventory.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics), Washington, DC
Comptroller of the Department of Defense, Washington, DC

Defense Contract Audit Agency

Headquarters, Defense Contract Audit Agency, Cameron Station, Alexandria, VA
Defense Contract Audit Agency, Southwestern Region, Los Angeles, CA
Defense Contract Audit Agency, East Bay Branch Office, San Francisco, CA
Defense Contract Audit Agency, Los Angeles Branch Office, El Segundo, CA

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Cameron Station, Alexandria, VA
Defense Contract Administration Services Region - Dallas, TX
Defense Contract Administration Services Region - Los Angeles, CA
Defense Contract Administration Services Region - Philadelphia, PA
Defense Contract Administration Services Management Area, El Segundo, CA
Defense Contract Administration Services Management Area, Phoenix, AZ
Defense Contract Administration Services Management Area, San Diego, CA
Defense Contract Administration Services Management Area, San Francisco, CA
Defense Contract Administration Services Management Area, Santa Ana, CA
Defense Contract Administration Services Management Area, Towson, MD
Defense Contract Administration Services Management Area, Van Nuys, CA

Defense Nuclear Agency

Headquarters, Defense Nuclear Agency, Alexandria, VA
Field Command, Defense Nuclear Agency, Kirtland Air Force Base, NM
Armed Forces Radiobiology Institute, Bethesda, MD

ACTIVITIES VISITED OR CONTACTED (Continued)

Other Defense Activities

Defense Criminal Investigative Service, Salt Lake City, UT

Other Government Activities

U.S. General Accounting Office, Washington, DC
U.S. Department of Energy, Las Vegas, NV

Contractors

BDM Corporation - Albuquerque, NM; McLean, VA
Bendix Field Engineering Corporation - Albuquerque, NM;
Columbia, MD; Las Vegas, NV; White Sands, NM
EG&G, WASC Inc., Albuquerque, NM
IRT Corporation, San Diego, CA
Jaycor, San Diego, CA
Maxwell Laboratories, Incorporated, San Diego, CA
S-Cubed, Division of Maxwell Laboratories, La Jolla, CA
Mission Research Corporation, Santa Barbara, CA
Physics International Company, San Leandro, CA
Pulse Sciences, Incorporated, San Leandro, CA
R & D Associates, Marina del Rey, CA
SRI International, Menlo Park, CA

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FINAL REPORT DISTRIBUTION

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics)
Director, Joint Staff

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)

Defense Agencies

Director, Defense Logistics Agency
Director, Defense Nuclear Agency

Non-DoD Activities

Office of Management and Budget
U.S. General Accounting Office

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations