Audit Report

COMPILATION OF DEFENSE REUTILIZATION AND MARKETING SERVICE OPERATING RESULTS

Report Number 00-023 October 28, 1999

Office of the Inspector General
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Acronyms

ABC	Activity-Based Costing
CFR	Code of Federal Regulations
DBOF	Defense Business Operations Fund
DFAS	Defense Finance and Accounting Service
DLA	Defense Logistics Agency
DRMS	Defense Reutilization and Marketing Service
GSA	General Services Administration
LESO	Law Enforcement Support Office
PBD	Program Budget Decision

INSPECTOR GENERAL
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October 28, 1999

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on the Compilation of Defense Reutilization and Marketing Service Operating Results (Report No. 00-023)

We are providing this report for review and comments. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we revised Recommendation A. to clarify our intention. The Under Secretary of Defense (Comptroller) and the Director, Defense Logistics Agency, comments to the recommendations were partially responsive. We request that the Under Secretary of Defense (Comptroller) and the Director, Defense Logistics Agency, provide additional comments on all recommendations by November 29, 1999.

We appreciate the courtesies extended to the audit staff. Questions about the audit should be directed to Mr. James L. Kornides at (614) 751-1400, extension 11 (jkornides@dodig.osd.mil) or Mr. Stuart D. Dunnett at (614) 751-1400, extension 14 (sdunnett@dodig.osd.mil). See Appendix B for the report distribution. The audit team members are listed inside the back cover.

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For Auditing

Office of the Inspector General, DoD

Report No. 00-023 **October 28, 1999**
(Project No. 8FJ-2013.00)

Compilation of Defense Reutilization and Marketing Service Operating Results

Executive Summary

Introduction. This report is part of a series of reports on the compilation of the Defense agencies' FY 1998 financial statements at the Defense Finance and Accounting Service Columbus Center, Columbus, Ohio. As a part of its mission, the DFAS Columbus Center compiles the financial statements for the Defense Logistics Agency (DLA). The Defense Reutilization and Marketing Service (DRMS) is one of five Working Capital Fund activity groups that make up the DLA Working Capital Fund.

Audit Objectives. The objective of this audit focused on the compilation of information used in the DRMS portion of the FYs 1997 and 1998 DLA financial statements. We determined whether the information used to prepare the DRMS portion of the DLA financial statements was consistent with information used to prepare operating budgets for FYs 1998, 1999, and 2000. In addition, we determined whether DRMS adequately collected and compiled revenue for goods and services it provided to the public and Government agencies.

Audit Results. The DRMS budgets for FYs 1998, 1999, and 2000 were prepared based on the assumption that surplus cash was transferred from DRMS to other DLA activity groups pursuant to a November 1996 budget decision. Those cash transfers were not made, a fact that would have been evident if the operating results from the DRMS financial statements were used in the formulation of the budget estimates. However, the accounting information from the financial statements was regarded as too unreliable to be used in the budget process. Analyses indicated that the accounting information was the best information available and should have been used. As a result of the confusion about the DRMS cash position, we estimate that high DRMS rates cost DRMS customers $351.4 million during FY 1998. As of September 30, 1998, DRMS had accumulated a surplus of approximately $400.4 million (Finding A).

From FYs 1992 through 1998, the DRMS provided disposal services at no cost to non-DoD organizations. We estimated that DRMS could recover costs between $129.2 million and $172.2 million by billing for disposal services provided to Federal and State organizations during the 6-Year Future Years Defense Program. In addition, unreimbursed costs previously incurred need to be reported on the FY 1999 Defense Logistics Agency Consolidated Statement of Net Cost (Finding B).

Implementing the recommendations will result in at least $529.6 million of funds put to better use for the Supply Management activity groups of the Military Department and Defense Logistics Agency Working Capital Funds. See the Finding section for the audit results.

Summary of Recommendations. We recommend that the Under Secretary of Defense (Comptroller) consider the actual cash position of the Defense Reutilization and Marketing Service during the next budget review and make appropriate cash transfers or billing rate adjustments; initiate action to propose that 41 Code of Federal Regulations 101-44.102(c) be changed to conform with title 40, United States Code, section 484(j) to allow for recovery of costs for the care and recycling of donations; request an exception to 41 Code of Federal Regulations 101-43.309-3 to recover the costs of care and handling of transfers to other Federal agencies; initiate actions to recover costs for the care and handling of property that is transferred to law enforcement agencies pursuant to title 10, United States Code, section 2576a; and establish a fee structure for DRMS to recover future disposal costs. We also recommend that the Director, Defense Logistics Agency, report on the FY 1999 Defense Logistics Agency Consolidated Statement of Net Cost the cost of disposal services provided to the public and Government agencies without charge.

Management Comments. The Director for Revolving Funds, Office of the Under Secretary of Defense (Comptroller), agreed to consider the actual cash position of the Defense Reutilization and Marketing Service during the next budget review and agreed to make appropriate cash transfers or billing rate adjustments if analysis demonstrated that a surplus existed. The Director also agreed there was a need to change 41 Code of Federal Regulations 101-44.102(c), and stated it was General Services Administration's responsibility to make the change. The Director stated that the General Services Administration was responsible for and given the funding for the costs of care and handling transfers to other agencies. The General Services Administration delegated the responsibility to DoD and did not provide the funding. The Director planned to discuss with the General Services Administration the possibility of obtaining funding. The Director stated it was not appropriate to initiate actions to recover costs for the care and handling of property that is transferred to law enforcement agencies and to establish a fee structure for the Defense Reutilization and Marketing Service.

The Deputy Director, Defense Logistics Agency, believed that the $400 million surplus from DRMS was returned to the Military Services in prior years. The Deputy Director nonconcurred with the need to report the cost of disposal services (provided at no cost to the public and Government agencies) on the FY 1999 Defense Logistics Agency Consolidated Statement of Net Cost. A discussion of management comments is in the Findings section of the report, and the complete text is in the Management Comments section.

Audit Response. The Directors' comments on the cash position of the Defense Reutilization and Marketing Service are responsive. We are requesting additional information from the Defense Logistics Agency regarding the disposition of the approximate $400 million surplus accumulated by the Defense Reutilization and Marketing Service. Although the Director agreed there was a need to change the Code of Federal Regulations, he did not provide any proposed corrective action. We also believe there is a need to recover the costs for the care and handling of property that is transferred to law enforcement agencies and to establish a fee structure. The Office of Management and Budget and DoD guidance specifically requires the disclosure of the cost of services provided to the public and Government agencies without charge. Accordingly, we request that the Under Secretary of Defense (Comptroller) and the Director, Defense Logistics Agency, provide additional comments in response to the final report by November 29, 1999.

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Background

Pursuant to the Chief Financial Officers Act and related laws, annual financial statements are prepared throughout the Federal Government to provide accountability and visibility over resources. Likewise, various regulations, including DoD Regulation 7000.14-R, the "DoD Financial Management Regulation," prescribe a variety of financial reports that, along with the annual financial statements, are intended to provide management with information that can be used to make informed program decisions, including budget decisions.

The Defense Finance and Accounting Service (DFAS) Columbus Center compiled the financial statements of the Defense Logistics Agency (DLA), DFAS, the Defense Commissary Agency, and the Defense Contract Audit Agency. Compilation consists of the preparation of financial statements from summary accounting information provided by financial and logistics feeder systems. The DFAS Columbus Center prepared the financial statements in a format that was defined by the Office of Management and Budget and implemented in DoD through guidance issued by the Under Secretary of Defense (Comptroller).

The Defense Reutilization and Marketing Service (DRMS) is one of five Working Capital Fund activity groups that make up the DLA Working Capital Fund, and information on DRMS is used to compile the DLA financial statements. DRMS manages various disposal programs, including public sales, hazardous waste disposals, reutilization of equipment by DoD organizations and Federal and State law enforcement agencies, transfers to Federal agencies, and donations to qualified State and local organizations. The financial results of these operations are summarized on the DRMS financial statements, which are compiled with the financial statements of other DLA activity groups.

DRMS became a working capital fund activity group in FY 1992. Since that time, DRMS has earned $3.0 billion in revenue, primarily through the retention of sales proceeds from its disposal programs and the collection of lump-sum billings from the Military Departments and the Defense Logistics Agency.

Objectives

The overall audit objective was to determine whether the Defense Finance and Accounting Service Columbus Center consistently and accurately compiled financial data from field activities and other sources for the financial statements of Defense agencies. This part of the audit focused on the compilation of information used in the DRMS portion of the FYs 1997 and 1998 Defense Logistics Agency financial statements. We determined whether the information used to prepare the DRMS portion of the DLA financial statements was consistent with information used to prepare operating budgets for FYs 1998, 1999, and 2000. In addition, we determined whether DRMS adequately collected and compiled revenue for goods and services it provided to the public and Government agencies.

A. Accounting for Defense Reutilization and Marketing Service Operating Results

The DRMS budgets for FYs 1998, 1999, and 2000 were prepared based on the assumption that surplus cash was transferred from DRMS to other DLA activity groups pursuant to a November 1996 budget decision. Those cash transfers in fact were not made, a fact which would have been evident if operating results from the DRMS financial statements were used in the formulation of the budget estimates. However, the accounting information from the financial statements was regarded as too unreliable to be used in the budget process. Analyses indicated the accounting information was the best information available, in this instance, and could have been used. As a result of the confusion about the DRMS cash position, we estimate that high DRMS rates cost DRMS customers $351.4 million during FY 1998. As of September 30, 1998, DRMS had accumulated a surplus of approximately $400.4 million. The surplus should be returned to the Military Departments and DLA supply management activity groups, or future rates should be reduced.

Accounting and Budgeting Guidance

Accounting Guidance. DoD Regulation 7000.14-R, volume 4, "Accounting Policy and Procedures," January 1995, provides accounting policy and procedures for DoD entities. The Regulation governs DoD financial management by establishing and enforcing requirements, principles, standards, systems, procedures, and practices necessary to comply with financial management statutory and regulatory requirements applicable to the DoD.

Among other procedures, the Regulation requires cash transfers to be posted to accounting records. It also defines the cumulative results of operations as the difference between expenses and losses and revenues and gains from inception through the end of a fiscal year.

Budget Guidance. DoD Regulation 7000.14-R, volume 11B, "Reimbursable Operations, Policy and Procedures -- Defense Business Operations Fund," December 1994, requires working capital fund activity groups to operate on a break-even basis over the long term. Customer orders (funded requests for goods or services) typically provide the budgetary resources necessary to finance operations of the working capital fund activity groups. Customer rates (fees) on the customer orders must be established on end products whenever feasible. The customer rates must be established at levels sufficient to recover the costs of the products or services, as well as any surcharges approved by the Under Secretary of Defense (Comptroller).

DoD Regulation 7000.14-R, volume 2B, "Budget Formulation and Presentation," June 1998, requires rates to be set to either make up actual or

projected losses or to return actual or projected gains in the budget year(s). The Regulation requires operating results for working capital fund activity groups to be summarized on revenue and expense statements. DLA provides revenue and expense statements for its activity groups with its budget submissions to the Under Secretary of Defense (Comptroller). Volume 2B requires operating results reported on the revenue and expense statements to be identical to the operating results presented on financial statements.

DoD Regulation 7000.14-R, volume 11B, requires DRMS rates to be established on an annual basis to recover its authorized costs. The rates are stabilized for 1 year and cannot be adjusted without the approval of the Under Secretary of Defense (Comptroller). Gains and losses are carried forward and are used to adjust subsequent rates.

DRMS budget requests are approved in versions of Program Budget Decision (PBD) No. 412, which are prepared on an annual basis by the Under Secretary of Defense (Comptroller) in coordination with the DLA Comptroller. The Deputy Secretary of Defense approves PBDs. DRMS budget execution is summarized on SF 133, "Report on Budget Execution," and compiled on the DLA Disaggregated Statement of Budgetary Resources. In addition, DRMS cash transfers, collections, and disbursements are summarized on SF 133 reports.

DRMS Program Budget Decisions

Program Budget Decision in December 1996. Officials from the Under Secretary of Defense (Comptroller) and the DLA Comptroller stated that DRMS had a large cash surplus through FY 1996, but it was transferred from DRMS to other DLA activities by the December 1996 version of PBD No. 412. They explained that after the surplus was transferred out, DRMS cumulative operating results were reduced to zero for purposes of computing the DRMS budget in December 1996. At that time, the DRMS SF 133 reports showed that DRMS had accumulated $447.4 million* in surplus collections from FYs 1992 through 1996. However, PBD No. 412, December 1996, did not authorize the transfer of DRMS cash, and the DRMS "Report on Budget Execution" (SF 133) from FYs 1992 through 1996 showed that no DRMS cash was transferred.

The DRMS revenue and expense statement that was submitted to Congress in February 1997 showed that no prior year adjustments had been made to DRMS cumulative operating results.

Budget Decision in November 1997. The assumption that a reduction in DRMS surplus collections had occurred in December 1996 was carried forward to the subsequent formulation of PBD No. 412 in November 1997. In November 1997, the Under Secretary of Defense (Comptroller) prepared PBD No. 412, with which the DLA Comptroller coordinated. PBD No. 412

*Note that DRMS collections increased because of the drawdown and subsequent sale of excess DoD inventories.

showed that DRMS accumulated an operating loss of $227.2 million through FY 1997, instead of the cumulative operating surplus of $164.4 million that was reported on the FY 1997 DRMS Financial Statements.

The November 1997 PBD established the billing rates for FY 1998, and as a result of carrying forward the reduction in revenue, DRMS billed and collected $351.4 million from the Military Department and DLA Supply Management activity groups in FY 1998.

Budget Decision in November 1998. On November 3, 1998, the Deputy Secretary of Defense approved PBD No. 412 and authorized DRMS to bill the Military Department and DLA Supply Management activity groups $93.6 million in FY 1999 and $100.9 million in FY 2000. At that time, PBD No. 412 was calculated using an estimated operating surplus of $26.0 million. However, the accounting records indicated that the DRMS cumulative operating surplus increased to $400.4 million, or the opening balance of the FY 1998 surplus of $164.4 million and the $236.0 million surplus reported on the FY 1998 DLA Consolidating Statement of Net Cost.

DRMS Operating Results

Under Secretary of Defense (Comptroller) officials stated that the information in the accounting records and the financial statements were not reliable.

To test the reliability of DRMS accounting information, we completed two analyses. We collected and analyzed the records of revenues and expenses and compared those amounts with amounts reported for collections and disbursements. Both sets of records have been maintained since the inception of the DRMS as a working capital fund activity group in FY 1992 and are used by DLA Comptroller personnel to execute and control the DRMS budget. The records are usually supported through extensive source documentation. Timing differences and accrual accounting procedures do result in differences between the two sets of records. The differences between the two sets of records were not material to the FY 1998 DLA Financial Statements and did not serve as a basis for our disclaimer of audit opinion on the FY 1998 DLA Financial Statements.

As shown in Tables 1 and 2, the accounting records continued to reflect a DRMS cumulative surplus in its operating results through the end of FY 1998.

Analysis of Cumulative Revenues and Expenses. DoD accounting procedures define cumulative operating results as the difference between revenues and gains and expenses and losses. From FY 1992 through FY 1998, DRMS did not report gains or losses on its financial statements. It reported the following revenues and expenses and resulting surplus or loss.

Table 1. Revenues Less Expenses

FY	Revenue	Expenses	Surplus/(Loss)
1992	$ 320,960,033	$ 280,171,628	$ 40,788,405
1993	271,626,702	396,541,992	(124,915,290)
1994*	622,201,446	367,289,330	254,912,116
1995	621,946,000	367,538,000	254,408,000
1996	308,311,000	368,891,000	(60,580,000)
1997	253,192,000	386,163,000	(132,971,000)
1998	589,676,000	353,716,000	235,960,000
	$2,987,913,181	$2,520,310,950	$ 467,602,231
	Minus Undistributed Transactions		(67,505,768)
Approximate Cumulative DRMS Surplus			**$ 400,096,463**

*Includes $155,953,405 in prior period adjustments.

We adjusted the reported revenues and expenses for undistributed disbursements and collections to account for differences between cash transactions reported to the U.S. Treasury and the cash transactions reported on DRMS accounting records.

The surplus of approximately $400.1 million from Table 1 is nearly identical to the $400.4 million operating surplus derived from the DLA financial statements (the opening balance of the FY 1998 surplus of $164.4 million and the $236.0 million surplus reported on the FY 1998 DLA Consolidated Statement of Net Cost).

Analysis of SF 133 Reports. Budget personnel from the Office of the Deputy Comptroller for Program and Budget told us that SF 133 reports were used to execute and control the DRMS budget.

Accordingly, we completed an additional analysis of DRMS collections and disbursements reported on Standard Form 133 reports from FY 1992 through FY 1998 to estimate the DRMS surplus on a cash basis (cumulative collections minus cumulative disbursements minus non-expenditure cash transfers).

Table 2. Collections Less Disbursements

FY	Collections	Disbursements	Surplus/(Loss)
1992	$ 186,886,711	$ 181,430,551	$ 5,456,160
1993	348,265,789	356,823,773	(8,557,984)
1994	602,423,910	375,653,992	226,769,918
1995	602,240,252	378,488,498	223,751,754
1996	288,814,868	378,920,276	(90,105,408)
1997	270,838,574	364,143,786	(93,305,212
1998	590,059,061	352,714,166	237,344,895
	$2,889,529,165	$2,388,175,042	$501,354,123
		Minus FY 1997 Transfers	(15,383,415)
		Minus Depreciation Expenses	(69,970,620)
Approximate Cumulative DRMS Surplus			**$416,000,088**

DRMS SF 133 reports showed that DRMS collected approximately $501.4 million more than it disbursed from FYs 1992 through 1998 ($2,889.5 million in cumulative collections minus $2,388.2 million in cumulative disbursements).

We adjusted the $501.4 million down to $416.0 million to account for $15.4 million in non-expenditure cash transfers reported for DRMS in FY 1997 and $70.0 million in depreciation expenses reported on the DLA Financial Statements for FYs 1992 through 1998. We made the depreciation adjustment because depreciation expenses are not reported on SF 133 reports. The $416.0 million surplus from Table 2 is slightly larger than the $400.4 million operating surplus derived from the DLA financial statements (the opening balance of the FY 1998 surplus of $164.4 million and the $236.0 million surplus reported on the FY 1998 DLA Consolidated Statement of Net Cost).

Official Accounting Information. The information we used to analyze the history of the financial position of DRMS was derived from official accounting records (records of revenues and expenses, and collections and disbursements). The same information was placed in the revenue and expense reports that accompanied the DRMS budget each year. The difference was that the DRMS cumulative operating results were not shown as surplus in FY 1996 or later budget documents. Because the surplus cash was not officially transferred out of DRMS, USD(C) and DLA Comptroller personnel should have used the information that showed the cumulative operating surplus to execute the DRMS budget and prepare budget submissions from FYs 1996 through 1998. Our two analyses of the official accounting information showed that the $400.4 million

cumulative operating surplus derived from the DLA financial statements (the opening balance of the FY 1998 surplus of $164.4 million and the $236.0 million surplus reported on the FY 1998 DLA Consolidated Statement of Net Cost) was the best information available and should have been used in DRMS budget decisions. Therefore, we believe that during the next budget review, the Under Secretary of Defense (Comptroller) should determine the actual DRMS cash position based on the official accounting information.

As a result of the understated cash positions used in the PBDs, we believe that DRMS collected an unneeded $351.4 million from the Military Department and DLA Supply Management activity groups during FY 1998. After DRMS collected the $351.4 million in billings in FY 1998, DRMS accumulated a surplus of approximately $400.4 million.

The objective of DRMS is to break even over the long term; therefore, the unnecessary collections provided a surplus that DRMS should not retain. DRMS should return the surplus to the Military Departments and DLA Supply Management activity groups, or future billings should be reduced. The reductions in DRMS billings will allow the Military Department and DLA Supply Management activity groups to reduce their recovery rates.

As of May 1999, DRMS was in the process of collecting $93.6 million in FY 1999 billings to the Military Department and DLA Supply Management activity groups. In addition, DRMS is authorized to bill the Military Department and DLA Supply Management activity groups $100.9 million in FY 2000.

Conclusion

DRMS budgets were mispriced because the Under Secretary of Defense (Comptroller) personnel believed that a November 1996 PBD had resulted in surplus cash being transferred to other activities. Financial records that showed otherwise were not considered reliable. The reluctance to rely on DoD accounting records is understandable, given the inability of DoD to comply with Federal standards for financial reporting. However, in this instance, the records comprise the best available information and should be used.

Recommendation, Management Comments, and Audit Response

Based on management comments we deleted the phrase "until the surplus is consumed" from the recommendation.

A. We recommend that during the next budget review, the Under Secretary of Defense (Comptroller) consider the actual cash position of the Defense Reutilization and Marketing Service and make appropriate cash transfers or billing rate adjustments.

Management Comments. The Director for Revolving Funds, Office of the Under Secretary of Defense (Comptroller), concurred with the recommendation and agreed to make appropriate cash transfers or billing rate adjustments if analysis demonstrated that a surplus existed. The Deputy Director, DLA, also concurred with the recommendation. The Deputy Director agreed that DRMS collections exceeded disbursements by approximately $400 million from FY 1992 through FY 1998. However, he believed the approximate $400 million surplus was in the Defense Wide Working Capital Fund, and that the DRMS funds were included in other funds returned to the Military Services in prior years.

Audit Response. The Office of the Under Secretary of Defense (Comptroller) comments are responsive. However, the comments from the DLA indicate that an analysis of the DRMS cash position has already been completed and that the approximate $400 million surplus was transferred to the Military Services in prior years.

On September 16, 1999, we discussed the DRMS cash position with the Director for Revolving Funds and the DLA Comptroller. During the meeting, DLA did not provide records to show that the approximate $400 million DRMS surplus was transferred to the Military Services in prior years. Instead, DLA indicated that the approximate $400 million DRMS surplus was used by DLA to liquidate obligations for the DLA Distribution Depot activity group. However, DLA did not record the transfer of cash from DRMS to the Distribution Depot activity group as required by DoD policy. As a result, we concluded that the approximate $400 million DRMS surplus could remain in the DLA Fund Balance With Treasury account at the end of FY 1998.

If approximately $400 million of the DRMS surplus accumulated from FYs 1992 through 1998 was used to liquidate obligations for the DLA Distribution Depot activity group, the transaction was not recorded in the accounting records, and there is no accounting evidence that the transaction caused a reduction in the billing rates of the Distribution Depot activity group. We believe the analysis of the DRMS surplus agreed to by the Office of the Under Secretary of Defense (Comptroller) needs to be completed to determine the status of the DRMS surplus. We request that Director, Defense Logistics Agency, provide us with a plan to account for the DRMS surplus as a part of his comments to the final report.

B. Providing Disposal Services to Non-DoD Organizations

In FYs 1992 through 1998, DRMS provided disposal services at no cost to non-DoD organizations because the Under Secretary of Defense (Comptroller) did not resolve regulatory and policy issues regarding the recovery of DRMS disposal costs from non-DoD customers. As a result, DRMS will not recover costs of between $129.2 million and $172.2 million that will be incurred when DRMS provides disposal services to Federal and State organizations during the 6-Year Future Years Defense Program. In addition, the unreimbursed costs previously incurred should be reported on the FY 1999 DLA Consolidated Statement of Net Cost.

Guidance on Establishing Fees

OMB Guidance. Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government," July 31, 1995, provides OMB guidance for cost accounting information in the Federal Government. The guidance states that cost information is important for setting fees and reimbursements. With certain exceptions, OMB requires that even if fees or reimbursements do not recover the full costs of programs because of policy or economic constraints, management needs to be aware of the difference between costs incurred and prices charged for services.

Statement of Federal Financial Accounting Standards No. 7, "Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting," May 10, 1996, provides standards for classifying, recognizing, and measuring resource inflows. The accounting standards require the recognition of revenue at the time a Government entity provides goods or services to the public or to another Government entity. The revenue is measured at the price likely to be received.

OMB Circular No. A-25, "User Charges," July 8, 1993, establishes Federal policy regarding fees assessed for Government services and for the sale or use of Government goods or resources. It provides information on the scope and types of activities subject to user charges and the basis for setting user charges. It also provides guidance for agency implementation of charges and the disposition of collections. When user charges are prohibited or restricted by law, agencies are required to review their activities periodically and recommend legislative changes when appropriate.

OMB Bulletin No. 97-01, "Form and Content of Agency Financial Statements," October 16, 1996, requires the Consolidated Statement of Net Cost and supporting schedules to show the net cost of operations for the reporting entity

as a whole and its sub-organizations and programs. Defense agencies must report the gross cost of goods, services, transfers and grants provided to the public and Government agencies without charge.

Regulatory and Policy Issues

The Under Secretary of Defense (Comptroller) did not resolve regulatory and policy issues regarding the fee structure for DRMS that were identified in two audit reports issued in 1994 and 1995.

Inspector General, DoD, Report No. 94-164, "Financial Statements of the Defense Reutilization and Marketing Service for FY 1993," June 30, 1994, concluded that DRMS should establish a fee structure based on costs of the individual services rendered to DoD customers. The Under Secretary of Defense (Comptroller) concurred with the audit recommendation and stated that the DRMS Unit Cost Working Group would address the issue of a DRMS fee structure. In a January 20, 1995, memorandum, the Under Secretary of Defense (Comptroller) suspended the working group and determined that, based on DRMS projected revenues from public sales proceeds, no basis existed to establish a fee structure through at least FY 1997.

Inspector General, DoD, Report No. 95-220, "Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994," June 5, 1995, recommended that the Under Secretary of Defense (Comptroller) reconvene the DRMS Unit Cost Working Group and develop a fee structure for DRMS. The Under Secretary of Defense (Comptroller) studied the issue of the fee structure, but in his "Plan to Improve the Management and Performance of the DoD Working Capital Funds," September 1997, he stated that DRMS would continue to be funded through billings to supply management activity groups.

Because no action was taken on the fee structure, DRMS provided disposal services at no cost to Federal and State organizations from FYs 1992 through 1997. In addition, we estimated that beginning in FY 2000, the Military Departments and DLA will pay DRMS between $129.2 million and $172.2 million in disposal costs during the 6-Year Future Years Defense Program to cover DRMS costs of care and handling incurred for reutilizations, transfers, and donations to Federal and State organizations. We estimated these amounts based on DRMS allocations of FY 1998 costs to the reutilization, transfer, and donation programs.

DLA Reutilizations to Federal and State Law Enforcement Agencies. DLA Law Enforcement Support Organizations (LESOs), in coordination with DRMS, authorize the transfer of DoD property under the provisions of title 10, United States Code (U.S.C.), section 2576a. The law prohibits the Secretary of Defense from expending funds on the transfers that would have otherwise been available to DoD for the procurement of defense equipment. The transfers were classified as reutilizations by DRMS because law enforcement agencies obtain sensitive items such as weapons that are not normally available to qualified recipients of DoD property.

DRMS did not charge a fee for the reutilizations, although DRMS incurred costs of approximately $8.8 million for care and handling for the transfers in FY 1998. The costs were recovered by DRMS through lump-sum billings, as discussed in Finding A. If the Military Departments and DLA had not been billed to cover the costs of the transfers, the $8.8 million could have been used for other DoD purposes. Based on a legal opinion that we received from DRMS counsel during the audit, we concluded that fees should be assessed for the transfers.

The DRMS opinion states that under 10 U.S.C. 2576a, law enforcement agencies could be required to pay DoD the costs of care and handling, as well as a purchase price for property transferred. DRMS counsel stated that any change to DLA policy should be coordinated with the U.S. Attorney General's Office and the Director of National Drug Control Policy.

We believe the Under Secretary of Defense (Comptroller) should initiate action to recover the costs for the care and handling of property transferred to law enforcement agencies.

Transfers and Donations to Federal and State Agencies Authorized by the General Services Administration. DRMS cannot charge a fee for donations and transfers authorized by the General Services Administration (GSA) because the Code of Federal Regulations (CFR) prohibits the recovery of the costs of care and handling for donations and transfers. In addition, GSA does not reimburse DRMS for processing costs, although GSA receives operating appropriations to cover the costs of donations and transfers processed under the CFR.

Recovery of Costs on Donations. 41 CFR 101-44.102(c) provides that a Federal agency, pending donation of property, is responsible for bearing costs for the care and handling of the property and that only direct costs incurred in actual packing and shipping may be reimbursable. However, 41 CFR 101-44.102(c) is in conflict with 40 U.S.C. 484(j), which specifically allows Federal agencies to recover the costs of care and handling for donations. The Under Secretary of Defense (Comptroller) should propose that 41 CFR 101-44.102(c) be changed to conform to 40 U.S.C. 484(j). If the proposed change is denied, the DoD should request a direct appropriation from Congress to cover the costs of care and handling for the donations.

Recovery of Costs on Transfers to Other Federal Agencies. 41 CFR 101-43.309-3 prohibits the recovery of the costs of care and handling for transfers to other Federal agencies. DRMS may recover only the direct costs of transfers, such as packing and shipping costs. Consequently, DoD customers are subsidizing other Federal agencies that benefit from the use of transferred DoD property.

The Under Secretary of Defense (Comptroller) should request an exception to 41 CFR 101-43.309-3 to permit DRMS to recover the costs of care and handling of excess property that is transferred to other Federal agencies. If the request for an exception is denied, DoD should request a direct appropriation from Congress to cover such costs, rather than including such costs in the billing rates charged to DoD customers.

Costs of Reutilizations, Transfers, and Donations. We estimated that the Military Departments and DLA will pay DRMS between $129.2 million and $172.2 million during the 6-Year Future Years Defense Program to cover the costs of care and handling for reutilizations, transfers, and donations to Federal and State organizations. We used the following methodology.

- DRMS determined that reutilizations, transfers, and donations were a homogenous base for the allocation of unit costs. We agree with the DRMS decision because the work required to process property on reutilizations, transfers, and donations is identical. For FY 1998, DRMS projected $70.4 million in total costs for the care and handling of property for reutilizations, transfers, and donations.

- Based on our trend analysis of DRMS operational data from FYs 1994 through 1997, we concluded that the DRMS allocation of $70.4 million for the costs of care and handling to reutilize, transfer, and donate property was consistent with operating results. Specifically, DRMS allocated 28.2 percent of its applicable operating costs to reutilizations, transfers, and donations. Our analysis of DRMS operational data showed that reutilizations, transfers, and donations represented about 30 percent of the total value of disposal actions on usable inventory from FYs 1995 through 1997.

- Of the $70.4 million of costs allocated to reutilizations, transfers, and donations for FY 1998, DRMS will incur about $8.8 million in costs for the care and handling of reutilizations to law enforcement agencies, $9.3 million for GSA transfers, and $10.6 million for donations to Federal and State organizations. The total FY 1998 cost subsidies to Federal and State organizations will be $28.7 million ($8.8 million plus $9.3 million plus $10.6 million).

- Based on the $28.7 million in FY 1998 costs, the high range of costs for reutilizations, transfers, and donations for the 6-Year Future Years Defense Program will be $172.2 million (6 years multiplied by $28.7 million). We provided a low range of costs totaling $129.2 million (75 percent of $172.2 million).

Additional Reporting Requirements. Beginning in FY 1998, DLA and DRMS were required to provide cost and revenue data on the Consolidated Statement of Net Cost in accordance with OMB Bulletin No. 97-01. The Consolidated Statement of Net Cost and supporting schedules should show the net costs of operations for the reporting entity as a whole and its suborganizations and programs. The Statement of Net Cost should report the gross cost of goods, services, transfers, and grants provided to the public and Government agencies without charge. The DRMS subsidized programs were not presented on the FY 1998 DLA Consolidated Statement of Net Cost and should be presented on the FY 1999 DLA Consolidated Statement of Net Cost.

Other Matters Regarding DRMS Fees

During the audit, the Under Secretary of Defense (Comptroller) changed DoD policies to allow DRMS to charge end users to recover the costs of administering reimbursable sales. However, he did not change policies to allow DRMS to recover the costs of administering hazardous disposal contracts on an end-user basis.

Fees for the Sale of Reimbursable Property. On June 25, 1998, DLA advised DRMS that it had the authority to recover its operating costs from the proceeds generated from the sale of reimbursable property. This change had been approved by the Deputy Secretary of Defense on November 24, 1997, in connection with PBD No. 412, and is fully consistent with 40 U.S.C. 485(c).

During the audit, DRMS completed an analysis of the projected FY 1998 costs related to the sale of reimbursable property. DRMS estimated the costs of processing the reimbursable property at 24 percent of the reimbursable sales proceeds. The DRMS analysis was consistent with prior year expenses from FYs 1995 through 1997. FY 1998 costs totaled $7.5 million (based on 24 percent of $31.3 million in reimbursable sales proceeds). The receipt of a fee for the reimbursable sales will provide additional budget authority for DRMS in future years.

Hazardous Materiel and Waste Disposal. DRMS managed contracts for the disposal of hazardous materiel and waste generated by DoD organizations. The Under Secretary of Defense (Comptroller) did not allow DRMS to recover its administrative costs on hazardous contracts, although no regulation or law prohibited the recovery of a fee on the contracts. In addition, after reviewing its costs, DRMS established a fee for service to non-DoD customers of 10 cents per pound of hazardous material or waste processed.

DRMS estimated that in FY 1999, it would incur $44.9 million in costs for the disposal of hazardous material and waste. The $44.9 million could be recovered through an end-user fee or through allocation of usage on Military Department and DLA billings. DRMS believed that it would be preferable to allocate the usage fees on hazardous contracts to the Military Departments and DLA because lower-level organizations are not prepared to administer environmental contracts locally. The Military Departments and DLA could request detailed data from DRMS to complete suballocations to their organizations and determine whether the local administration of contracts would compete with DRMS services.

DRMS Initiatives. DRMS officials told us that they support establishing a fee structure to recover the costs of disposal operations. During FY 1997, DRMS fielded an activity-based costing (ABC) system developed by KPMG Peat Marwick, L.L.P., which became fully operational in FY 1998. The ABC system was implemented to improve DRMS financial performance and achieve cost-conscious decision making. After discussions with DLA personnel responsible for developing the ABC system, we concluded that the ABC system could support a DRMS fee structure.

Summary

Although the use of Military Department and DLA billings is permissible to fund DRMS operations, implementing a fee structure for DRMS would improve financial management for DRMS and its customers. In addition, the Military Departments and DLA should not subsidize non-DoD organizations with working capital funds, and DLA should report the subsidies on its FY 1999 Consolidated Statement of Net Cost. The Under Secretary of Defense (Comptroller) should resolve these regulatory and policy issues and implement an appropriate fee structure for DRMS for FY 2000.

Recommendations, Management Comments and Audit Response

B.1. We recommend that the Under Secretary of Defense (Comptroller):

a. Initiate action to propose that 41 Code of Federal Regulations 101-44.102 (c) be changed to conform with title 40, United States Code, section 484(j).

b. Request an exception to 41 Code of Federal Regulations 101-43.309-3 to recover the costs of care and handling of transfers to other Federal agencies.

c. Initiate actions to recover costs for the care and handling of property that is transferred to law enforcement agencies pursuant to title 10, United States Code, section 2576a.

d. Establish a fee structure for the Defense Reutilization and Marketing Service to recover disposal costs in FY 2000.

Management Comments. The Director for Revolving Funds, Office of the Under Secretary of Defense (Comptroller), concurred with the intent of Recommendation B.1.a., and stated the General Services Administration needed to make the necessary changes. The Director also concurred with Recommendation B.1.b., and stated it is the responsibility the General Services Administration to dispose of all excess property. The Director stated that the General Services Administration is funded to accomplish this task. The General Services Administration delegated the responsibility for disposal of excess property to the Department but did not provide funding. The DoD plans to meet with the GSA and discuss the possibility of obtaining funding to recover the cost of transfers to other agencies. The Director nonconcurred with recommendations B.1.c. and stated that he had the prerogative to not recover the costs of the services. It is to the benefit of the Federal Government for agencies to acquire and reutilize DoD property. Charges for reutilization may reduce the amount of equipment reutilized and result in additional procurements by other agencies. The Director nonconcurred with Recommendation B.1.d. and stated that the DRMS activity-based cost accounting system is not developed to a point where it could generate a fee structure and that a more complex fee structure for DRMS would increase DRMS' operating costs with no benefits to customers.

Audit Response. The Director concurred with the intent of the recommendation B.1.a., but offered no implementation of actions. DoD can propose to the General Services Administration that changes be made to the Code of Federal Regulations. The planned action for Recommendation B.1.b. is acceptable unless the General Services Administration does not provide a funding source. In that case, the Department should request the exemption to the Code of Federal Regulations so DoD can recover the costs.

Comments to recommendations B.1.c. are not responsive. DoD working capital funds currently subsidize the services provided. If the DoD decides not to recover the cost of such services through fees, DoD should take an alternative action such as requesting a direct appropriation from Congress. We also disagree with the comments on Recommendation B.1.d. Results from our audit indicated that DRMS already expended funds to implement a complex cost accounting system. Also, DRMS was using an activity based cost accounting system for a number of functions including the allocation of resources to DRMS activities and the formulation of budget submissions. We request the Under Secretary provide additional comments on the recommendations and provide cost data to show that implementing a fee structure would increase DRMS costs.

B.2. We recommend that the Director, Defense Logistics Agency, report on the Defense Logistics Agency FY 1999 Consolidated Statement of Net Cost the cost of disposal services provided to the public and Government agencies without charge.

The Deputy Director, Defense Logistics Agency, nonconcurred with the recommendation. He stated that DLA complied with Office of Management and Budget (OMB) and DoD policies and guidance in compiling the DLA Consolidated Statement of Net Cost for FY 1998. DLA believed its responsibility segments presented on the FY 1998 Consolidating Statement of Net Cost were appropriate.

Audit Response. Disclosing the costs of disposal services provided to the public and Government agencies without charge on the FY 1999 DLA Consolidated Statement of Net Cost could be done without establishing additional DLA responsibility segments. OMB and DoD policies and guidance specifically require agencies to report the costs of services provided to the public and Government agencies without charge on the Statement of Net Cost or on supporting schedules to the statement. We ask the DLA to provide further comments to the recommendation.

Appendix A. Audit Process

Scope and Methodology

Work Performed. We reviewed the reasonableness of $445 million in Military Department and DLA billings for disposal services. Specifically, we determined whether the DRMS cumulative results of operations used in budget decisions were reconcilable to the financial data reported on prior year financial statements. We determined whether DRMS was providing goods and services to the public and Government agencies without charge. We obtained the data from audit research and from IG, DoD, Report No. 98-148, "Internal Controls and Compliance With Laws and Regulations for the FY 1997 Financial Statements of the Defense Logistics Agency Working Capital Fund," June 8, 1998.

We reviewed the status of DRMS initiatives for developing a fee structure and determined whether regulatory and policy impediments had been resolved by the Under Secretary of Defense (Comptroller) in accordance with applicable OMB and DoD guidance.

Use of Computer-Processed Data. We analyzed summary accounting records provided by DFAS for DRMS collections and disbursements from FYs 1992 through 1998. We performed trend analyses of the data to identify material irregularities in the supporting data. To determine whether DRMS cost accounting data for FY 1998 were reasonably allocated to its disposal programs, we analyzed DRMS summary data from FYs 1994 through 1997. We obtained the data from audit research and from IG, DoD, Report No. 98-148. In a memorandum issued on February 27, 1998, we disclaimed an opinion on the DLA financial statements. We did not use statistical sampling techniques.

DoD-wide Corporate-Level Government Performance and Results Act (GPRA) Goals. In response to the GPRA, the DoD established 6 DoD-wide corporate-level performance objectives and 14 goals for meeting these objectives. Project No. 8FJ-2013.00 pertains to the achievement of the following objective and goal.

> **Objective:** Fundamentally reengineer DoD and achieve a 21st century infrastructure.
> **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objectives and goals.

- **Financial Management Functional Area**
  Objective: Reengineer DoD business practices.

Goal: Standardize and enhance DoD working capital fund operating procedures. **(FM-4.2)**

- **Financial Management Functional Area**
  Objective: Strengthen internal controls.
  Goal: Improve compliance with the Federal Managers' Financial Integrity Act. **(FM-5.3)**

General Accounting Office High-Risk Area. The General Accounting Office had identified several high-risk areas in the DoD. This report provides coverage of the financial management high-risk area.

Audit Type, Dates, and Standards. We performed this financial-related audit from April 1998 through June 1999 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

We did not review the management control program because internal controls related to the DoD financial statements for FY 1998 are covered in other segments of this audit project and in a separate report.

Prior Audit Coverage

The Inspector General, DoD, has issued two reports with related audit coverage on DRMS operating results.

Report No. 94-164, "Financial Statements of the Defense Reutilization and Marketing Service for FY 1993," June 30, 1994.

Report No. 95-220, "Financial Statements of the Defense Logistics Agency Reutilization and Marketing Service Business Area of the Defense Business Operations Fund for FY 1994," June 5, 1995.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Acquisition and Technology)
  Deputy Under Secretary of Defense (Logistics)
  Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Logistics Agency
  Commander, Defense Reutilization and Marketing Service
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations

Office of Management and Budget
General Accounting Office
  National Security and International Affairs Division
    Technical Information Center

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

Under Secretary of Defense (Comptroller) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-1100

COMPTROLLER
(Program/Budget)

OCT 5 1999

MEMORANDUM FOR DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, DoD INSPECTOR GENERAL

SUBJECT: Draft Audit Report on the Compilation of Defense Reutilization and Marketing Service (DRMS) Operating Results (Project No. 8FJ-2013.00)

The Office of the Under Secretary of Defense (Comptroller) was requested to comment on the subject draft report. We have reviewed the subject audit report and have the following comments:

Recommendation # 1: The Under Secretary of Defense (Comptroller) will consider the actual cash position of the Defense Reutilization and Marketing Service during the next budget review and make appropriate cash transfers or billing rate adjustments. Should analysis demonstrate that a surplus exists we recommend adjustment be made.

DoD Response: The Department concurs with the current revision that deletes "until the surplus is consumed", and inserts the sentence "Should analysis demonstrate that a surplus exists, we recommend adjustment be made".

Recommendation #2: Initiate action to propose that 41 Code of Federal Regulations 101-44.102 (c) be changed to conform with title 40, United States Code, section 484(j).

DoD Response: The Department agrees that there should be consistency between the Code of Federal Regulations and title 40. However, it is the responsibility of GSA to make the necessary changes to the Code of Federal Regulations.

Recommendation # 3: Request an exception of 41 Code of Federal Regulations 101-43.309.3 to recover the costs of care and handling of transfers to other Federal agencies.

DoD Response: It is GSA who is responsible for the costs of care and handling of transfers to other Federal agencies. GSA has the obligation to dispose of all excess government property and it is GSA who is funded by Congress to accomplish this task. GSA has delegated the responsibility of disposal to the Department and has not provided the required funding to accomplish this task. Therefore, the Department intends to meet with GSA and discuss the possibility of obtaining funding to cover the cost of care and handling of transfers to other Federal agencies.

Recommendation #4: Initiate actions to recover costs for the care and handling of property that is transferred to other agencies pursuant to 10 United States Code 2576a.

DoD Response: It is the Secretary's prerogative not to recover costs associated with the transfer of DoD property. It is to the benefit of the Federal government for agencies to acquire and reutilize surplus DoD property. Charging for reutilization might reduce the amount of equipment reutilized and therefore increase costs to the Federal Government through additional procurement.

Recommendation #5: Establish a fee structure for DRMS to recover future disposal costs in FY 2000.

DoD Response: DRMS already has a fee structure to recover their disposal costs. The DRMS' operating costs recovered by the surcharge paid by the supply business activities is based on the amount of net sales generated in the supply business activities. There is a direct relationship between the amount of DRMS' funding derived from a supply business activity and the amount of supply sales generated. The more items a supply activity sells, the more items will ultimately arrive at DRMS for disposal; hence the costs are spread proportionately. In addition, the Activity-Based Costing System does not currently have the capability to support a more complex fee structure. A more complex fee structure would increase DRMS' operating costs with no benefits to the customers.

William C. Coonce
Director for Revolving Funds

Defense Logistics Agency Comments

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IN REPLY REFER TO FO

OCT 0 1 1998

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on the Compilation of Defense Reutilization and Marketing Service Operating Results (Project No. 8FJ-2013.00)

We appreciate the opportunity to comment on this audit report, your willingness to meet with us, and your agreement to modify specific wording when the final report is issued. Based on meetings and phone conversations with the Comptroller, DLA, we understand you have agreed to remove the sentence, "However, this explanation was mistaken.", from page 3, paragraph 3 of the draft report, as well as modify the Recommendation on page 7 to read:

"We recommend that the Under Secretary of Defense (Comptroller) consider the actual cash position of the Defense Reutilization and Marketing Service during the next budget review."

DLA concurs with Finding A, contingent upon these changes appearing in the final report. We agree that collections exceeded disbursements for the Defense Wide Working Capital Fund (DWWCF) activity group, Reutilization and Marketing, by approximately $400 million from beginning of period (BOP) fiscal year 1992 through end of period (EOP) fiscal year 1998. We disagree, however, that this translates to the "cash position" of this activity group or to a "cash balance" available for consideration in future budget reviews. DWWCF cash is managed at the fund vs. activity group level. No activity group has a "cash position" and activity group requirements compete with DoD-wide requirements for the use of cash excess to DWWCF requirements. Management at the fund level results in a reduced on hand cash requirement and provides increased management flexibility to apply cash on a priority basis across the Department.

During the period cited in the audit report, over $4 billion cash generated by the DWWCF has been directly transferred to the Military Services, used to offset DWCF losses, and used for rate reductions in DWCF activity groups. Therefore, any cash generated by the Reutilization and Marketing activity group during this period has already been considered in the budget process and effectively returned to the Military Services.

For reasons previously stated, DLA will continue to manage DWWCF cash at the fund vs. activity group level, and in our capacity as the DWWCF cash manager, we will continue to analyze DWWCF cash requirements and make appropriate budget and financing recommendations with respect to cash to the DoD Comptroller. With respect to the recommendation for Finding A, we agree that the actual cash position of the DWWCF should

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continue to be considered in the budget process. Our comments on Finding B recommendations are attached.

RAYMOND A. ARCHER III
Rear Admiral, SC, USN
Deputy Director

Attachment

Audit Report on the Compilation of Defense Reutilization and Marketing Service Operating Results
(Project No. 8FJ-2013.00)

DLA Comments on Finding B

DLA partially concurs with Finding B, Recommendations 1.a. – 1.d. DLA will support any initiatives deemed appropriate by the Department with regard to legislative/regulatory reform impacting the cost or financing of disposal operations. We agree that the Defense Reutilization and Marketing Service (DRMS) incurs costs in disposing of DoD items that are eventually transferred or donated to non-DoD activities. We do not agree that these costs should be totally borne by the end users. DRMS exists, not as a broker for non-DoD activities, but to dispose of DoD items declared excess. DRMS incurs costs as a result of this mission, not as a result of an item's ultimate end use. Item managers and property owners dictate workload and, therefore, costs. The same level of costs, with the exception of transportation costs, would be incurred with or without the transfer and donation processes being performed by DRMS. In fact, we believe higher costs would be incurred without those processes. In the case of the incremental transportation costs incurred as a result of these functions, these are currently paid by the end user.

The audit report also recommends that a fee structure be established in FY00 to recover disposal costs. The report indicates that the activity based cost (ABC) system currently used to allocate DRMS costs to defined processes would support such an initiative. While DLA is in support of any initiative that enhances our financial management abilities, we do not believe that the ABC system has been developed to the point that it would support a fee structure meeting DWWCF requirements.

The final audit report recommendation concerns DLA CFO reporting. DLA non-concurs with Finding B. Recommendation 2. We complied with Office of Management and Budget (OMB) and DoD policies and guidance in compiling the consolidating statement of net cost for our FY98 financial statements and intend to comply in FY99. DoD has indicated that DLA activity groups vs. processes within those groups are the appropriate "responsibility segments" for Chief Financial Officer's Act (CFO) reporting purposes. It appears that the audit report's recommendation is based on a different interpretation. If so, then this recommendation should be directed to the DoD Comptroller.

Attachment

Audit Team Members

This report was prepared by the Finance and Accounting Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report.

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