Audit Report

OFFICE OF THE INSPECTOR GENERAL

MANAGEMENT OF THE U.S. ARMY CENTER FOR MILITARY HISTORY EXCHANGE-FOR-SERVICES AGREEMENT

Report No. 97-211 August 28, 1997

Department of Defense

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Acronyms

AMC	Army Materiel Command
AR	Army Regulation
CMH	Center for Military History
DRMS	Defense Reutilization and Marketing Service
SECO	Southeastern Equipment Company, Incorporated

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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August 28, 1997

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Management of the U.S. Army Center for Military History Exchange-for-Services Agreement (Report No. 97-211)

We are providing this report for review and comments. Management comments on a draft of this report were considered in preparing the final report. The complete text of the comments is in Part III.

DoD Directive 7650.3 requires that all internal audit issues be resolved promptly. Based on management comments and subsequent discussions with Army personnel, Recommendation 4. was added after the draft was published. Therefore, we request that the Commander, Army Materiel Command provide further comments on Recommendations 1., 2.,3., and 4. by October 21, 1997. Part I of the report gives the specific requirements for additional comments.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. Stuart D. Dunnett, Audit Project Manager, at (614) 751-1400 (e-mail JKornides@DODIG.OSD.MIL or SDunnett@DODIG.OSD.MIL). See Appendix C for the report distribution. The audit team members are listed on the inside back cover.

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Office of the Inspector General, DoD

Report No. 97-211 **August 28, 1997**
(Project No 5FJ-5024.04)

Management of the U.S. Army Center for Military History Exchange-for-Services Agreement

Executive Summary

Introduction. This is the fifth in a series of reports resulting from our audit of Controls Over the Reutilization, Transfer, Donation, and Sales of Munitions List Items (Project No. 5FJ-5024). The former Director, Defense Logistics Agency, requested the audit. Other published reports in the series are summarized in Appendix B. On September 21, 1994, the U.S. Army Center for Military History initiated a 5-year exchange-for-services agreement with the Southeastern Equipment Company, Incorporated, that required the company to provide search, salvage, and restoration services directly benefiting the historical collection of the Army for artifacts to be determined by the Army Chief of Military History. The Army titled the exchange-for-services agreement "Exchange for Services - 10 U.S.C. 2572" because it was based on the provisions of section 2572 of title 10 United States Code, which allows the exchange of condemned or obsolete combat material for the direct benefit of the Military Departments' historical collections. As of August 1996, the Army reported that the contractor had provided $4.1 million in services under the agreement.

Audit Objective. The primary objective of the overall audit was to evaluate whether the Defense Reutilization and Marketing Service and the Defense Contract Management Command were appropriately reutilizing, transferring, donating, and selling munitions list items. Munitions list items are military articles that require special handling on disposal to prevent their unauthorized use by domestic or foreign purchasers. We also determined whether management controls over the disposal of munitions list items were adequate. A subobjective of this part of the audit was to evaluate the Army's management of its "Exchange for Services - 10 U.S.C. 2572" agreement, since munitions list items were involved in exchange transactions.

Audit Results. The U.S. Army Center for Military History (the Center) did not properly manage its "Exchange for Services - 10 U.S.C. 2572" agreement. The Center did not make use of outdoor storage areas; underutilized 3 warehouses; allowed the Southeastern Equipment Company, Incorporated, to store contractor-owned property in 2 of the warehouses; exchanged 16 helicopters for less than reasonable, objective values; and subsidized the operations of the Southeastern Equipment Company, Incorporated, by paying transportation costs on exchanges. As a result, we estimated that the Center overstated its liability to the Southeastern Equipment Company, Incorporated, by at least $1.1 million and undervalued the helicopters it exchanged with the company by approximately $1 million.

The audit identified management control weaknesses (Appendix A). We also identified monetary benefits of at least $2.1 million.

Summary of Recommendations. We recommend that the Commander, Army Materiel Command:

o Assess the need for an exchange agreement with the Southeastern Equipment Company, Incorporated. As part of the assessment, thoroughly evaluate the availability and possible use of the Air Force Aerospace Maintenance and Regeneration Center for long-term storage of historic aircraft.

o Compute the Government's liability to the Southeastern Equipment Company, Incorporated, under the "Exchange for Services - 10 U.S.C. 2572" agreement, using reasonable, objective valuations and correct inventory records to value and document the helicopters that were transferred. The computation should fully account for the transportation and storage costs that were incurred by the Government but benefited the Southeastern Equipment Company, Incorporated.

o Direct the U.S. Army Center for Military History to establish a management control program as required by DoD Directive 5010.38.

o Provide a full accounting for helicopters transferred by Army organizations to the Army Center for Military History.

Management Comments. The Chief of Military History disagreed with a number of the findings and recommendations, but he acknowledged shortcomings in the Center's administration of its exchange-for-services agreement with the Southeastern Equipment Company, Incorporated. He stated that during the last 6 months, the U.S. Army Audit Agency, working with the Army Materiel Command, has conducted an extensive review of Center operations, including the exchange-for-services agreement. As a result, the Army intends to implement detailed recommendations to improve the Center's business practices. He also stated that the Center has incurred a substantial liability to Southeastern Equipment Company, Incorporated, under the exchange-for-services agreement and owes the company $2.1 million. He stated that while the Army's internal review was pending, all exchange transactions were suspended. He opined that, now that the review is completed, the Center should be allowed to resume exchange transactions for the purpose of liquidating its obligation to the Southeastern Equipment Company, Incorporated.

Audit Response. The Army's actions taken to improve its business practices will result in a stronger management control environment. However, we disagree with the Army's calculation of the amount owed to Southeastern Equipment Company, Incorporated and concluded that outdoor storage costs should be reduced by at least $955,000. After we received management comments on our draft report in June 1997, we asked the Army for updated invoices to support the amounts owed to Southeastern Equipment Company, Incorporated. The Army provided the invoices on June 24, 1997, and we identified mathematical errors of $547,364 and six months of duplicate billings for outdoor storage totalling $946,200. Army data also showed that over 900 automotive vehicles were authorized for release to the contractor as partial payment for services, and over 500 were subsequently provided to the contractor. These exchanges were not on the records provided during the audit, and there was no evidence they were used to offset the contractor's charges. The Army should consider those issues before making a final payment under the exchange-for-services agreement. The recommendation to provide a full accounting for helicopters transferred by Army organizations to the Army Center for Military History was added after the draft report. We request that the Chief of Military History provide additional comments on the final report by October 21, 1997.

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Part I - Audit Results

Audit Background

This is the fifth in a series of reports resulting from our audit of Controls Over the Reutilization, Transfer, Donation, and Sales of Munitions List Items (Project No. 5FJ-5024). The overall audit was requested by the Director, Defense Logistics Agency. Appendix B summarizes four earlier reports, Report No. 96-143, "Transfer and Exchange of a Navy P-3A Aircraft," June 5, 1996; Report No. 96-229, "Disposition of Excess Army Helicopters and Flight-Safety-Critical Helicopter Parts," September 24, 1996; Report No. 97-130, "Coding of Munitions List Items," April 16, 1997; and Report No. 97-134, "Disposal of Munitions List Items in Possession of Defense Contractors," April 22, 1997.

On September 21, 1994, the U.S. Army Center for Military History (CMH) initiated a 5-year exchange-for-services agreement with the Southeastern Equipment Company, Incorporated (SECO) that requires SECO to provide search, salvage, and restoration services directly benefiting the historical collection of the Army for artifacts to be determined by the Army Chief of Military History. The Army titled the agreement "Exchange for Services - 10 U.S.C. 2572," because it was based on the provisions of section 2572 of title 10 United States Code (U.S.C.), which allows the exchange of condemned or obsolete combat material for the direct benefit of the Military Departments' historical collections. SECO was also required to provide adequate storage for historic artifacts. As of August 1996, the Army reported that SECO had provided $4.1 million in services under the agreement.

Audit Objective

The primary objective of the overall audit was to evaluate whether the Defense Reutilization and Marketing Service (DRMS) and the Defense Contract Management Command were appropriately reutilizing, transferring, donating, and selling munitions list items. Munitions list items are military articles that require special handling on disposal to prevent their unauthorized use by domestic or foreign purchasers. We also determined whether management controls over the disposal of munitions list items were adequate. See Appendix A for a discussion of our review of management controls. A subobjective of this part of the audit was to determine whether the Army properly managed its "Exchange for Services - 10 U.S.C. 2572" agreement with SECO, since munitions list items were involved in exchange transactions.

CMH Management of Exchange for Services

The CMH did not properly manage its "Exchange for Services - 10 U.S.C. 2572" agreement. Specifically, the CMH did not make use of outdoor storage areas and underutilized three warehouses leased under the agreement. In addition, the CMH allowed SECO to store contractor-owned property in 2 of the warehouses; exchanged 16 helicopters for less than reasonable, objective values under the agreement; and subsidized SECO operations by paying transportation costs on exchanges. These conditions occurred because the CMH:

o leased indoor and outdoor storage space based on the amount of excess property it expected to receive, rather than on approved transfers from DRMS and from Army commands that supplied property;

o did not use less costly storage facilities for long-term storage of excess helicopters;

o did not comply with Army procedures on property accountability and valuation for 16 helicopters;

o did not offset transportation costs incurred by the Government in shipping helicopters to the storage facilities;

o did not enforce billing and reporting provisions on $2.3 million of costs reported under the "Exchange for Services - 10 U.S.C. 2572" agreement; and

o did not establish a management control program to evaluate and report material weaknesses, as required by DoD Directive 5010.38.

As a result, we estimate that CMH overstated its liability to SECO by at least $1.1 million and undervalued the 16 helicopters it exchanged with SECO by approximately $1 million.

DoD and Army Exchange Procedures

DoD Procedures. On May 23, 1988, the Deputy Assistant Secretary of Defense (Logistics) made the Military Departments responsible for implementing controls over exchanges of historical items by DoD museums. In his memorandum, the Deputy Assistant Secretary of Defense (Logistics) instructed the Military Departments to complete exchanges that were in the best interest of the Government.

DoD 4160.21-M, "Defense Reutilization and Marketing Manual," March 1990, was revised on November 13, 1992, to provide procedures on transfers of

excess property from the DRMS to DoD and military museums. The manual prohibits museums from stockpiling material obtained from Defense Reutilization and Marketing Offices. The manual also requires DoD activities to request only property authorized for release by the parent headquarters or commands. DoD activities must consider the significance of costs incidental to the transfer of excess property, including transportation costs, support, and repair costs. DoD activities may not request quantities of property that exceed authorized retention limits.

Army Accountability Procedures. Accountability for the disposition of historic property is prescribed by Army Regulation (AR) 870-5, "Military History: Responsibilities, Policies and Procedures," July 12, 1993, and AR 870-20, "Museums and Historic Artifacts," January 9, 1987. AR 870-5 prohibits the reuse of historic artifacts for their original purposes. AR 870-20 requires the CMH to dispose of excess historic artifacts in accordance with DoD 4160.21-M. AR 870-20 requires all museums and historical holdings to conduct biennial inventories of collections. At the time of our audit, CMH controlled the disposition of the Army's historic property. AR 870-5 designated the Commander/Chief of Military History as the principal advisor to the Secretary of the Army and the Chief of Staff of the Army on historical matters. The Director, Army Staff, maintains AR 870-5.

CMH Procedures for Approval, Valuation, and Billing of Exchange Transactions. On November 1, 1994, CMH issued interim procedures for the management of its "Exchange for Services - 10 U.S.C. 2572" agreement with SECO. The interim procedures were applicable to all exchanges reviewed during the audit. The procedures supplemented AR 870-20 and required each exchange to be processed through the Committee to the Chief Curator. The Chief Curator numbered each exchange transaction in a document control log. The Chief Curator or his representative was responsible for signing and dating control documents such as transfers of title.

CMH interim procedures also required an Accession/Deaccession Committee to approve the valuation of exchange property. This committee was required to consider the following factors before approving valuations: the original purchase cost, the Foreign Military Sales (FMS) program, commercial market prices, commercial market conditions, and the overall condition of the exchange property.

To receive property under the agreement, SECO was required to submit invoices that detailed the tasks it had performed for the Army. The invoices were to be certified and approved by the CMH exchange coordinator as part of the transfer process. If CMH did not reject invoices within 30 days of receipt, this would constitute acceptance by CMH.

Management Control Program. DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

CMH Management of Exchange for Services Agreement

The CMH did not properly manage its "Exchange for Services - 10 U.S.C. 2572" agreement. From September 1994 through August 1996, CMH reported $2.5 million in storage costs for outdoor storage areas that were not used and three warehouses that were underutilized. In addition, CMH allowed SECO to store contractor-owned property in two of the warehouses.

Storage Space Leased Under the Agreement. CMH leased outdoor and indoor storage space based on the amount of excess property it expected to receive, rather than on approved transfers from DRMS and from Army commands that supplied property. CMH planned to stockpile large quantities of helicopters and other condemned or obsolete excess property, although Army commands and DRMS were not obligated to provide large quantities of excess property to CMH. DoD 4160.21-M prohibits DoD museums from stockpiling condemned or obsolete munitions list items obtained from DRMS.

Storage Costs. On September 21, 1994, CMH contracted with SECO to provide storage space at outdoor storage areas and three warehouses. SECO was responsible for submitting billing invoices for the storage space, and CMH was responsible for certifying the invoices before making payment on the agreement. As of August 8, 1996, CMH reported the following costs on the exchange agreement:

Storage Facility	Cost Reported
Outdoor Storage	$1,582,825
Warehouse No. 1	332,640
Warehouse No. 2	215,253
Warehouse No. 3	381,150
Total	**$2,511,868**

Leasing of Outdoor Storage Space

We reviewed SECO's billing of outdoor storage costs under the exchange-for-services agreement and concluded that CMH had not incurred $1,582,825 in outdoor storage costs. Contemporaneous documents showed that outdoor storage costs incurred under the agreement were as low as $425,946 and no higher than $627,618. As a result, CMH overstated outdoor storage costs by between $955,207 and $1,156,879.

The CMH overstatement occurred, because CMH computed storage costs based on 697,280 square feet of outside storage, whereas, contemporaneous contractor documents showed that only 193,100 square feet of outside storage was leased by CMH during FYs 1995 and 1996.

FY 1995 Costs. The semiannual report submitted by SECO in September 1995 showed outdoor storage costs of $348,706 for 193,100 square feet of outdoor storage leased by CMH for 11 months during FY 1995. The $348,706 of incurred costs are consistent with the terms of the September 21, 1994, exchange-for-services agreement with SECO. The costs were also consistent with contractor invoices submitted to CMH in May and June of 1995.

FY 1996 Costs. On October 1, 1995, the CMH Chief Curator signed an amendment to the exchange-for-services agreement that reduced the FY 1996 outdoor storage costs from $1.97 per square foot per year to $.40 per square foot per year. The change would have reduced storage costs to $77,240 (193,100 square feet times $.40) or $278,912 (697,280 square feet times $.40) for FY 1996.

FY 1997 Costs. On October 15, 1996, the Chief Curator signed an amendment to the exchange-for-services agreement that reduced the FY 1997 outdoor storage costs to $.40 per square foot per year, per square foot utilized. CMH did not use any of the space and did not incur any costs during FY 1997.

Total Outdoor Storage Costs. Based on our reconstruction of costs from contemporaneous documents, we estimated that CMH incurred $425,946 ($348,706 plus $77,240) in actual outdoor storage costs from FYs 1995 through 1996. However, CMH believes it needs to pay $278,912 for FY 1996 based on 697,280 square feet at $.40 per square foot which would make the total costs $627,618 ($348,706 plus $278,912).

As of August 8, 1996, CMH reported $1,582,825 in outdoor costs from FYs 1995 through 1996. On January 8, 1997, we informed CMH management that the liability to SECO was overstated by about $1.1 million ($1,582,825 minus $425,946). After discussing the draft report with Army management, we concluded that the liability for outdoor storage costs could be as low as $995,207 ($1,582,825 minus $627,618) if the Army determines that 697,280 square feet of outdoor storage was leased during FY 1996.

Use of Outdoor Storage. The outdoor storage was not utilized by CMH during the audit, because anticipated transfers from other Army organizations and DRMS did not occur.

Excess Army Property Not Available. In January 1994, CMH determined that 135,750 square feet of outdoor storage would be required to store equipment that the U.S. Army in Europe was declaring as excess property. The storage space would be needed if the transfers were approved by the Army Materiel Command (AMC). In addition, CMH identified another 62,439 square feet of outdoor storage that would be needed if excess equipment was shipped from other storage locations in the United States. However, CMH personnel told us that AMC did not approve the projected requirements, because funds were not available to transport the excess equipment. Also, the outdoor storage area was a secured space that CMH intended to use for helicopter storage. However, CMH did not receive the helicopters, because DoD halted all helicopter transfers to CMH in July 1995.

DRMS Transfers. CMH planned to use the remaining outdoor storage space to store property it would requisition from DRMS. CMH obtained a small amount of property from DRMS between December 1995 and April 1996. However, DoD 4160.21-M prohibited the stockpiling of excess property from DRMS. A DoD policy memorandum, "Loans, Gifts, and Exchanges," November 22, 1996, also prohibited the stockpiling of condemned or obsolete munitions list items in anticipation of future exchanges. Because the policy restricted excess, obsolete, and condemned items, CMH was not able to obtain the excess property as expected.

Leasing of Warehouse Facilities

CMH was also leasing three warehouses from SECO. CMH could not fully use the warehouses and allowed SECO to store contractor-owned material in Warehouses No. 1 and No. 3. The facilities were underutilized because CMH requests for excess property were only partially filled by Army commands and DRMS.

Warehouse No. 1. This indoor storage area (48,000 square feet) is in a building that SECO used in its restoration business. Historic tanks and aircraft stored in the warehouse were in various stages of restoration. During our visit to SECO in September 1996, we could not identify the amount of CMH property stored in the warehouse, because the property was not tagged and SECO did not maintain records of the warehouse's contents.

We identified two CMH items in the warehouse that were shown as being shipped to SECO on CMH invoices. A German Panzer tank stored in the building was shipped to SECO on a January 1995 tasking order from CMH. In addition, a condemned mobile crane was obtained from DRMS in December 1995 and shipped to the warehouse from Florida at a cost of more than $6,000 to CMH. The mobile crane was not historic property and did not require indoor storage.

During FY 1995, CMH had not performed an inventory as required by AR 870-20. In addition, CMH management did not maintain records of materials stored in the warehouse. As a result SECO was allowed to use the warehouse to store property that SECO intended to sell or restore. For example, an F-7U aircraft stored in the warehouse was advertised for sale by SECO in a trade publication. CMH officials also stated that an AH-1 Cobra mock-up owned by SECO was stored in the Government-leased facility.

Contractor invoices from May and June of 1995 show that only 27,000 square feet of the warehouse was being leased by CMH. However, CMH summary records as of August 8, 1996, showed that 48,000 square feet were leased for 21 months at $3.96 per square foot for a total cost of $332,640. The incurred costs for 27,000 square feet for 21 months at $3.96 would have been $187,110, which is $145,530 less than shown on CHM summary records. Since SECO

continued to use the Warehouse in its own business, it is not clear what CMH's incurred costs on the warehouse should be.

Warehouse No. 2. During our visit in September 1996, Warehouse No. 2 (28,000 square feet of climate-controlled storage) was approximately 80 percent empty. It contained three vehicles, two motorcycles, three artillery pieces, several Civil war cannon patterns (used to manufacture cannons), and six other historic artifacts. The warehouse also held several file cabinets with historical data. The material was shipped to SECO from November 1994 through March of 1996. After our visit, CMH shipped additional material from the Anniston Army Depot to the warehouse.

Property tags were assigned to all items in the warehouse, and we did not identify any SECO owned property. In addition, contractor invoices and CMH summary records agree that 28,000 square feet was leased during FY 1995 and FY 1996.

Warehouse No. 3. CMH had intended to use Warehouse No. 3 (55,000 square feet) to stockpile helicopters. The warehouse had 122 slots designated for helicopters. However, as of September 1996, only 45 CMH helicopters were stored in the building, because transfers of helicopters were halted by DoD in July 1995.

We identified 98 helicopters from contractor invoices that were shipped to SECO from January 1995 through July 1995. We could not account for the disposition of 29 of 98 helicopters due to inadequate CMH records. Of the 98 helicopters, 45 were on-hand, 16 were transferred to SECO on the exchange-for-services agreement, and 8 helicopters were transferred to SECO on a goods-for-goods exchange in May 1996. Property accountability problems are discussed in more detail on page 9 of this report.

SECO was using the facility to store 10 of the 24 UH-1 helicopters transferred to SECO during our audit. Of the 10 helicopters, 4 were transferred to SECO in June 1995 as reimbursement for leased storage space under the exchange-for-services agreement. The remaining six helicopters were transferred to SECO in May 1996 as part of a goods-for-goods exchange with SECO. SECO did not offer, nor did CMH request, compensation for the space used by SECO.

Due to the inaccurate records, it is difficult to estimate how much of Warehouse No. 3 was actually used by CMH. Based on data from contractor invoices, we concluded that zero helicopters were stored in the facility until January 1995, no more than 45 helicopters were stored from January 1995 through May 1995, and no more than 74 CMH helicopters were stored in the facility from June 1995 through September 1996.

Options for the Long-term Storage of Helicopters

The CMH decision to use Warehouse No. 3 for the long-term storage of 122 helicopters at SECO was questionable. Other options were available and could have been considered. For example, the Military Departments routinely store excess helicopters and fixed-wing aircraft at the Air Force Aerospace Maintenance and Regeneration Center (AMARC), Tucson, Arizona. AMARC personnel are skilled in flight safety, demilitarization, and reclamation. The Navy Museum stores historic aircraft at AMARC for a fee of $140 per aircraft per year. The annual fee at AMARC is $1,645 less per aircraft than the cost to store aircraft in Warehouse No. 3, assuming that all 122 slots in Warehouse No. 3 are used. The Army should evaluate the possible use of AMARC for long-term storage of historic helicopters.

Property Accountability and Property Valuation

CMH accountability over helicopters stored at SECO and its controls over the valuation of exchanges were not adequate under the exchange-for-services agreement. CMH transfers of title did not identify serial numbers for 39 helicopters transferred by CMH in property-for-property exchanges. In addition, transfers of 16 helicopters to SECO under the exchange-for-services agreement were executed without proper dating of the transfer of title. As a result, the exact number of helicopters transferred to SECO under the exchange-for-services agreement was not available.

Incomplete Property Accountability Records

We followed up on conditions discussed in Audit Report No. 96-229, September 24, 1996, "Disposition of Excess Army Helicopters and Flight-Safety-Critical Helicopter Parts." The report identified 84 excess helicopters on CMH records that needed to be disposed of in accordance with DoD policy. However, the location and status of the 84 helicopters were not available during our visits to CMH or SECO facilities. CMH records were not adequate and failed to provide an audit trail for the helicopters. As a result, we could not determine how many of the 84 helicopters had been exchanged by CMH.

Specifically, we reviewed contracts on CMH exchanges that occurred between FYs 1991 and 1996. We identified 170 helicopters that were exchanged with private entities or museums during that period. Of the 170 helicopters, 39 were not identified by serial number on the CMH transfer documents. Identification by serial number is necessary to properly account for the disposition of the helicopters.

Approval of Transfers by Chief Curator. CMH management control procedures require the Chief Curator to sign and date transfer-of-title documents before exchanging helicopters. After the documents are signed, title to the helicopters is transferred through the issuance of Federal Aviation Administration bills of sale. However, CMH did not always comply with the transfer procedures on completed exchanges.

Documents Signed After Transfers of Title. On document W74R7L-5308-0002, November 1995, CMH transferred five OH-58 and five UH-1 helicopters to SECO under the exchange-for-services agreement. Transfer documents for the 10 helicopters were signed on July 25, 1996. However, SECO sold three of the OH-58 helicopters in January 1996, 6 months before the Chief Curator signed the transfer-of-title documents.

The exchanges took place during a moratorium on helicopter exchanges in DoD. In a July 25, 1995, memorandum, the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management) issued a moratorium on any further liabilities related to helicopters or helicopter parts. DoD requested that the Military Departments immediately amend their regulations to prohibit museums from providing surplus helicopters and related parts and components to private individuals or organizations through exchanges. In a March 11, 1996, memorandum, the Assistant Secretary of the Army (Installations, Logistics, and Environment) agreed to implement procedures in compliance with the DoD memorandum. He stated that CMH had halted all helicopter exchange transactions as of August 29, 1995.

In a November 22, 1996, memorandum, the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management) rescinded the July 25, 1995, memorandum and permitted exchanges of helicopters and other obsolete or condemned combat material. The policy prescribes controls and procedures to control the release of munitions list items and flight-safety-critical parts to the public. In addition, the November 22, 1996, memorandum required exchange transactions to be approved by the Military Departments' legal and financial staffs. Museum operations personnel may not act as the sole approving authority for any exchange transaction.

Undated Transfer-of-Title Documents. CMH transferred six additional UH-1 helicopters to SECO under document W74R7L-5156-0002. Although the transfer documents were signed, the effective date of the transfer was not entered on the document, and CMH did not have Federal Aviation Administration bills of sale on the six helicopters. Therefore, we were not able to validate the date of the transaction.

Reconciliation of Army Records. The Secretary of the Army transferred operational control of all museum transactions from CMH to the AMC on December 12, 1996. On February 14, 1997, we were informed that the AMC was developing procedures for accountability, demilitarization, and the storage of historic property.

Based on management comments to the draft report and a subsequent meeting with the Army, we concluded that corrective actions have not been taken to

fully account for helicopters transferred to CMH by other Army organizations. Therefore, we added a recommendation to ensure that CMH records are reconciled to transfer records maintained by other Army organizations.

Valuation of Exchange Transactions

Valuation. CMH did not properly value exchange transactions as required by its procedures. Specifically, CMH did not consider commercial market prices, commercial market conditions, and the overall condition of the exchange property. Instead, CMH relied on the contractor to estimate the value of exchange property.

We discussed this condition in Audit Report No. 96-229, "Disposition of Excess Army Helicopters and Flight-Safety-Critical Helicopter Parts," September 24, 1996, and the Army agreed to take corrective action to improve the valuation process. However, we expanded our audit of transactions and found examples that warrant further attention, including a recalculation of the Government's liability under the service agreement.

We analyzed the valuations on the two exchanges discussed above (documents W74R7L-5308-0002 and W74R7L-5156-0002). We determined that SECO obtained the 11 UH-1 and 5 OH-58 helicopters at less than reasonable, objective values. Actual sales of similar helicopters and property-for-property exchanges completed by CMH indicate that the UH-1s were undervalued by $673,000, and the OH-58s were undervalued by $275,000. CMH also incurred costs of at least $40,000 to transport the helicopters to SECO facilities. The transportation costs were not included in the valuation process, although SECO normally incurred transportation costs to move excess property to its facilities.

Valuation of UH-1s. CMH procedures require consideration of market prices and conditions when valuing exchange property. However, CMH established the values of UH-1s without verifying market prices through the DRMS and undervalued the UH-1s compared to a CMH property-for-property exchange (document W74R7L-5188-0008), June 7, 1995.

In August 1995, DRMS sold a UH-1 helicopter in unflyable condition for $133,000 at the request of the Army Deputy Chief of Staff for Logistics. The sale was requested by the Army to determine the market value of excess UH-1 helicopters. Based on the test sale, we concluded that 11 similar UH-1s transferred to SECO should have been valued at $1,463,000.

All 11 UH-1s were classified in unflyable condition. In addition, Army disposal records showed that 6 of the 11 helicopters (valued by CMH at $65,000 each) were classified in the same Federal Condition Code as the helicopter sold by DRMS. Federal Condition Codes assigned to the other 5 helicopters (valued by CMH at $80,000 each) were not verifiable, because Army disposal records were being moved during the audit. CMH valued the

11 UH-1s at $790,000, for a potential loss of $673,000 compared to the estimated $1,463,000 that DRMS could have received from a competitive sale.

CMH also valued similar UH-1s at $130,000 on a property-for-property exchange initiated by CMH during the same time period. Specifically, On June 7, 1995, CMH valued 5 UH-1s on a property-for-property exchange (document W74R7L-5188-0008) at $130,000 each. CMH valuation records state that the 5 UH-1s were "like the ones we had been receiving, they have been exposed to the elements for several years and have been stripped of some key components and contain the -10 engines with medium to good times." On June 5, 1995, CMH valued 6 similar helicopters at $65,000 each on the exchange-for-services agreement (document W74R7L-5156-0002). CMH has been unable to explain why similar helicopters were valued so differently during the same time period.

Valuation of OH-58s. In July 1995, SECO transported 10 flyable OH-58s from active Army units to Warehouse No. 3 at Government expense. SECO sold three of the OH-58s in January 1996 for $115,000 each, without making any improvements to the helicopters. In addition, CMH valued 1 of the 10 OH-58 helicopters at $115,000 on a property-for-property exchange (document W74R7L-5157-0002) completed with SECO in May 1996.

Based on the prior sale by SECO and the property-for-property exchange transaction completed by CMH, we concluded that $115,000 more closely represented the fair market value for each of the 10 OH-58 helicopters. However, CMH transferred 5 of the 10 helicopters to SECO for $60,000 each on the exchange-for-services agreement under document W74R7L-5308-0002. The exchange of the five OH-58 helicopters resulted in a potential loss of $275,000 ($55,000 for each helicopter) to the Government.

Consideration of Transportation Costs

The valuations used by CMH also did not consider transportation costs incurred by the Government that benefited SECO. Since September 21, 1994, CMH paid $380,000 to SECO to move commercially-salable helicopters and other excess property from DoD activities to Warehouses No. 1 and No. 3. The transportation costs represented a direct subsidy to SECO; in accordance with DoD 4160.21-M, the impact of those costs should have been considered before the transfers were authorized.

The services that SECO provided to CMH are available from other buyers of excess helicopters and equipment. However, other buyers are required to pay transportation costs when purchasing similar equipment in competitive sales administered by DRMS. During our visit, SECO employees stated that SECO routinely purchased equipment from DRMS activities and paid transportation and storage costs for the equipment. We believe that CMH should receive credit for any transportation costs it incurred in moving commercially-salable helicopters to contractor facilities. The DoD memorandum of

November 22, 1996, states that costs related to exchanges of condemned or obsolete combat materiel are normally paid by the recipient of the materiel.

Reporting and Billing of Contractor Costs

As of August 8, 1996, CMH reported $4.1 million of costs for services provided by SECO under the exchange-for-services agreement. However, CMH provided us with only $1.8 million of invoices from SECO. The remaining $2.3 million of costs were recorded on CMH summary records, but CMH did not have contractor invoices for the costs.

Cost Reporting. The exchange-for-services agreement required SECO to report expenses semiannually to CMH. A semiannual report was due in the first week of September 1996. As of January 8, 1997, SECO had not provided the semiannual report to CMH. This occurred because CMH did not enforce the reporting provisions in the agreement.

Billing Provisions. The agreement stated that prior to payment, the CMH exchange administrator was responsible for certifying and approving billings (invoices) submitted by SECO. The exchange administrator was also responsible for submitting the certified invoices to the Chief Curator. The Chief Curator signed and dated the transfer-of-title documents. As of January 8, 1997, CMH was still not certifying contractor invoices.

Lack of a Management Control Program

CMH did not establish a management control program to monitor its exchange-for-services agreement in compliance with DoD Directive 5010.38, "Management Control Program," August 26, 1996.

During our visits, CMH stated that they were not aware of the requirement for a management control program. AMC should ensure that CMH establishes a management control program as required by DoD Directive 5010.38.

Conclusion

The CMH "Exchange for Services - 10 U.S.C. 2572" agreement was not properly managed. CMH underutilized the storage space leased under the agreement and did not establish adequate controls over property accountability, property valuation, use of Government-leased facilities, and invoices to SECO under the agreement. CMH stated that they had altered the exchange-for-

services agreement to reduce the costs of outdoor storage, but the reductions in costs were not shown on CMH records. The Secretary of the Army transferred operational control of museum property transactions to the AMC as of December 12, 1996. The Army needs to account for helicopters transferred to under its 10 U.S.C 2572 program. The Army also needs to recompute its liability to SECO under the "Exchange for Services - 10 U.S.C. 2572" agreement. Specifically, CMH overstated storage costs by at least $1.1 million (at least $955,000 for outdoor storage plus $145,520 for indoor storage), understated the value of 16 helicopters transferred to SECO under the agreement by $1 million. In addition, CMH allowed SECO to use two of the warehouses leased under the exchange-for-services agreement. The Army also needs to determine whether a credit is due for transportation costs incurred for the helicopters that were eventually exchanged with SECO. The potential monetary benefit to the Army from recomputing the Government's liability would be at least $2.1 million.

Management Comments on the Finding and Audit Response

Management Comments. The Chief of Military History concurred with the finding that the CMH did not base its storage requirement on approved transfers. However, he stated that the CMH based only a portion of its requirements on the amount of excess property it expected to receive. He stated that the CMH has a continuing need to store some historical property and is reviewing and refining its storage requirements.

Audit Response. We agree that a reassessment of the CMH storage requirements is needed. At the conclusion of the audit, personnel at the Army Aviation and Troop Command told us that the Army had requirements, including foreign military sales, for all remaining excess helicopters in its inventory. As a result, the CMH will not be receiving excess Army aircraft, and its requirements for storage will be considerably less than anticipated.

Management Comments. The Chief of Military History stated that CMH had used the least costly storage facilities available. He stated that the Air Force facilities were not evaluated because long-term storage was not needed. However, the CMH had evaluated other Army sites, including some sites in Europe, and had determined that the exchange-for-services agreement was the most prudent resourcing option. He stated that the Army Audit Agency has made recommendations to the CMH for ensuring that the exchange process is administered in a sound manner consistent with applicable law.

Audit Response. At the time of the audit, the CMH could not provide us with any analysis of the other options it claimed to have studied from a cost perspective. We request that the CMH provide us with its analysis of the other options reviewed for storage and other services, and a copy of its plan for ensuring that future exchange provisions are administered in a sound manner consistent with applicable law.

Management Comments. The Chief of Military History disagreed that the CMH undervalued 16 helicopters that it exchanged for services. He stated that DoD and the Army did not have procedures for valuing property for exchange transactions, but the CMH process was at least as valid as the IG, DoD, process, because the IG, DoD, based its finding on one DRMS sale of a UH-1 helicopter and a DRMS sale of three UH-58s. He stated that the IG, DoD, did not appraise the 16 helicopters exchanged and that the value of the aircraft can vary considerably depending on age and condition. He also stated that since the 16 aircraft are no longer under DoD control, it is impractical to conduct retroactive appraisals.

Audit Response. We agree that DoD procedures for valuing property for exchange transactions were lacking. New requirements for developing procedures are being incorporated into the revised version of DoD 4160.21M, "Defense Reutilization and Marketing Manual." However, as stated in our draft report, the CMH had interim procedures in place at the time of the audit for valuing property for exchange transactions. Those procedures were not followed. Our valuations of the 16 aircraft exchanged by the CMH were conservative. We used information from test sales of two UH-1s to make our assessment. The test sales were directed by the Army Deputy Chief of Staff for Logistics in May 1995. DRMS sold the two helicopters in August and December 1995 for $133,000 and $135,000, respectively. The condition of both helicopters was listed as poor at the time of their sale. Although records from the CMH exchange of the 16 helicopters indicated that all were in fair condition, the CMH valued them at $65,000 to $80,000 each. Our valuation of the OH-58 aircraft was based on sales by SECO of 3 of the 16 helicopters that it received from the CMH, not on a DRMS sale of 3 OH-58 aircraft. The selling price is a good indicator of the market value of the aircraft. The amount that CMH obtained for the helicopters was not reasonable. The Army needs to obtain the proper value to recompute what is actually owed.

Management Comments. The Chief of Military History nonconcurred with the finding that the CMH overstated its liability to SECO by $1.1 million. He stated that the correct square footage leased was 697,280, not 193,100 square feet, as stated in the audit report.

Audit Response. At the time of the audit, the CMH provided invoices showing that the square footage leased was 193,100 square feet. In June 1997, AMC provided us with invoices to support the 697,280 square feet of space it now claims it leased. The comments from the Chief of Military History indicate that the Army did not verify, from a local government map, the acreage it was leasing until after the lease was completed. Also, the new invoices for the 697,200 square feet of space were signed but not dated. Army Audit Agency personnel told us that the invoices were prepared after it had completed its review of the lease. Also, although the CMH used the new square footage to justify the $2.1 million it claims it still owes to SECO, we identified calculation errors of $547,364 and duplicate billings of $946,200 on the invoices. We believe that CMH has overstated its liability.

Management Comments. The Chief of Military History stated that CMH had not overstated its liability to SECO because it allowed the contractor to use

space in two warehouses without obtaining consideration. He stated that the use of this space by SECO did not conflict with use by CMH, that CMH consented to the arrangement, and that no legal basis exists for the Government to claim consideration.

Audit Response. The Government paid funds to lease space that was used by the lessor. No other legal basis is needed to request an offset to the lease cost.

Recommendations, Management Comments, and Audit Response

Added recommendation. Based on management comments and subsequent discussions with the Army we added Recommendation 4. below.

We recommend that the Commander, Army Materiel Command:

1. Assess the need for an exchange-for-services agreement with the Southeastern Equipment Company, Incorporated. As part of the assessment, thoroughly evaluate the availability and possible use of the Air Force Aerospace Maintenance and Regeneration Center for long-term storage of historic aircraft.

Management Comments. The Chief of Military History concurred with the recommendation. He stated that CMH is currently in the process, with AMC, of reassessing its storage requirements. He stated that CMH has considered other means for storage and other services and has concluded that the exchange agreement (goods for services) meets its needs at the lowest cost, provided that appropriate management controls are in place.

Audit Response. We agree that the CMH needs to reassess its storage requirements. However, the Chief of Military History did not provide an estimated date for completing the action. We request that the Chief of Military History provide a completion date for the reassessment as part of his response to this final report. We also request that CMH provide a copy of its analysis of the other options for storage and other services, and a copy of its plan for ensuring that the exchange process is administered in a sound manner consistent with applicable law.

2. Compute the Government's liability to the Southeastern Equipment Company, Incorporated, under the "Exchange for Services - 10 U.S.C. 2572" agreement, using reasonable, objective valuations and correct inventory records to value and document the helicopters that were transferred. The computation should fully account for the transportation and storage costs that were incurred by the Government but benefited the Southeastern Equipment Company, Incorporated.

Management Comments. The Chief of Military History nonconcurred with the recommendation. He stated that AMC worked with SECO, CMH, and the

Army Audit Agency to clear up shortcomings in documentation and to clarify commitments made between CMH and SECO. He agreed that the previous process and documentation were inadequate, but said the CMH liability was correctly stated and payment of the amounts owed should be made as expeditiously as possible.

Audit Response. The CMH liability to the Southeastern Equipment Company was not correctly stated. On June 18, 1997, we received comments from the Chief of Military History on our draft report. We then requested that AMC provide us with updated invoices from the contractor to support the amounts that CMH indicated it still owed to SECO. AMC provided the invoices on June 24, 1997. We reviewed the invoices and identified mathematical errors of $547,364 and six months of duplicate billings for outdoor storage totalling $946,200. The U.S. Army Tank Automotive Command also provided us with data showing that over 900 automotive vehicles were authorized for release to the contractor as partial payment for services, and over 500 were subsequently provided to the contractor during the period of our audit. The exchanges were not on the records provided to us during the audit, and there was no evidence they were used to offset the contractor's charges. Finally, CMH did not provide evidence that it asked SECO to reduce billings to compensate CMH for the use by SECO of SECO facilities leased to the Army. CMH needs to consider those issues before making a final payment under the exchange-for-services agreement. We request that the Chief of Military History reconsider his comments and provide additional comments on the final report.

3. Require the Commander/Chief of Military History to establish a management control program as required by DoD Directive 5010.38.

Management Comments. The Chief of Military History concurred with the recommendation to establish a management control program as required by DoD Directive 5010.38.

Audit Response. The CMH comments were responsive. However, the Chief of Military History did not provide an implementation date for the proposed action. We ask that CMH include the implementation date in its comments on the final report.

4. Provide a full accounting for helicopters transferred by Army organizations to the Army Center for Military History.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

Scope. We compared data obtained at the CMH to data maintained by SECO, which provided services to the Army. Specifically, we reviewed documents on $4.1 million of services provided by SECO under the "Exchange for Services Agreement - 10 U.S.C. 2572" from September 21, 1994, through August 8, 1996. We inspected an outdoor storage area and three warehouses leased by CMH under the agreement. We determined whether the storage facilities were being utilized in an efficient manner and whether the Government was incurring overhead costs that should have been paid by SECO. We also evaluated the valuation of exchanged helicopters based on reasonable, objective values. On January 7 and 8, 1997, we visited CMH to obtain year-end data for FY 1996. CMH could not provide the year-end data.

Methodology. Because CMH did not have an automated system for maintaining records on exchange transactions, we analyzed data maintained on CMH personal computers. We did not use statistical sampling methodology or computer-processed data during this audit.

Audit Period, Standard, and Locations. We performed this economy and efficiency audit from August through January 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

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

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to establish a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed CMH reporting under the management control program. CMH did not have a formal management control program consisting of a process for safeguarding assets, including policies, procedures, and methods for reporting weaknesses to higher headquarters. Therefore, it did not report a material management control weakness in the exchange-for-services agreement.

Adequacy of Management Controls. We identified material control weaknesses as defined by DoD Directive 5010.38. Recommendation 3. will establish a management control program, and Recommendations 1. and 2. will assist in correcting the weakness in the exchange-for-services agreement.

Appendix B. Summary of Prior Coverage

This report is the fifth in a series. The other four reports include:

Inspector General, DoD, Report No. 96-143, "Transfer and Exchange of a Navy P-3A Aircraft," June 5, 1996. The Navy planned to transfer a P-3A aircraft, with usable parts valued at $1.7 million to $4.1 million, to the Smithsonian's National Air and Space Museum. The museum, in turn, planned to exchange the P-3A for an historically significant business aircraft valued at $245,000. As a result of our review, the Navy conducted further research and canceled the transfer. The Navy confirmed that it had current requirements for parts on the P-3A. In addition, the planned exchange was not in the best interest of the Government. Management actions resulted in monetary benefits of $1.7 million to $4.1 million. Because the Navy took corrective actions, the report contained no recommendations.

Inspector General, DoD, Report No. 96-229, "Disposition of Excess Army Helicopters and Flight-Safety-Critical Helicopter Parts," September 24, 1996. The Aviation and Troop Command did not give correct instructions for disposing of flight-safety-critical helicopter parts. As a result, $37.5 million of flight-safety-critical parts were released to the public without safety inspections, and $153.1 million of salable parts were incorrectly coded for demilitarization.

The Aviation and Troop Command transferred 170 helicopters to the CMH for exchange purposes, although the helicopters were not historic property. The CMH incorrectly exchanged 86 of the helicopters for other historic property or contractor services. The helicopters that were exchanged were not properly valued, and the exchanges were not reported to the Internal Revenue Service as required. The CMH actions did not comply with DoD policies on exchanges and the valuation requirements of 10 U.S.C., section 2572. The exchanges increased the risk that flight-safety-critical helicopter parts on the helicopters were released outside DoD without the necessary safety inspections.

The DRMS did not reimburse the Aviation and Troop Command for the sale of excess helicopters and related parts. As a result, the Army Defense Business Operations Fund will not receive approximately $60 million from the sale of helicopters and $10 million from the sale of helicopter engines. Redirecting these funds will give the Army the incentive to maximize proceeds on the sale of excess helicopters and related parts.

The Army agreed to publish policy requiring the inspection of helicopters prior to exchange; destroy flight-safety-critical parts that are undocumented, crash-damaged, or similarly compromised; inform recipients of helicopters and parts of the availability of historical data on flight-safety-critical parts; notify the end-users of the 86 helicopters of the existence of flight-safety-bulletins; revise Army Regulation 870-20, "Museums and Historical Artifacts," to include valuation procedures; abide by DoD policy on the reporting of exchanges to the Internal Revenue Service; and comply with the tenets of a legal opinion on the reimbursement for the sale of helicopters and related parts.

Inspector General, DoD, Report No. 97-130, "Coding of Munitions List Items," April 16, 1997. The policies governing the coding of munitions list items were adequate. However, DoD organizations did not follow those policies and assigned inaccurate codes to more than half of the items we reviewed. Our random statistical sample indicated that from October 1994 to May 1995, DoD Components assigned inaccurate demilitarization codes to 1,380 (52 percent) of the 2,658 randomly sampled items that required strict controls for disposal. Decentralization of the demilitarization coding process made it difficult to adequately train personnel and ensure the consistent application of demilitarization policies. Inaccurate codes were assigned. DoD may have incurred unnecessary costs and sensitive military hardware may have been sold or advertised for sale without demilitarization controls. Improvements in the assignment of demilitarization codes are essential overall and as anti-terrorism, security, and property management measures. The Deputy Under Secretary of Defense (Logistics) concurred with the recommendations and began actions to centralize management of the coding process. He also requested further study of the issue by the Defense Science Board.

Inspector General, DoD, Report No. 97-134, "Disposal of Munitions List Items in Possession of Defense Contractors," April 22, 1997. Improvements were needed in the identification and disposal of munitions list items in the possession of contractors. At the 15 contractor locations we visited, DoD and Defense contractor personnel generally did not identify whether items used by contractors to develop and field weapon systems were munitions list items. Of the 1,820 items we judgmentally sampled, 1,400 were not reviewed or categorized. As a result, when the property was no longer needed, the Defense Contract Management Command directed Defense contractors to sell it, without knowing whether any of the property required strict controls to keep it from unauthorized recipients. Also, the Defense Contract Management Command did not adequately monitor the disposal of 155 items that DoD personnel identified as munitions list items. As a result, the items were sold without application of the required trade security and demilitarization procedures. The Defense Logistics Agency and the Defense Contract Management Command initiated corrective actions to change the procedures used to identify items in the possession of contractors. The Director, Defense Procurement, agreed to consider our report recommendations as comments on proposed changes to the Defense Federal Acquisition Regulation Supplement on demilitarization.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
  Deputy Under Secretary of Defense (Logistics)
  Director, Defense Logistics Studies Information Exchange
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Chief of Staff of the Army
Commander, Army Materiel Command
Auditor General, Department of the Army
Commander/Chief of Military History, Center for Military History

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

Defense Organizations

Director, Defense Contract Audit Agency
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
U.S. General Accounting Office
- National Security and International Affairs Division, Technical Information Center
- National Security and International Affairs Division, Defense and National Aeronautics and Space Administration Management Issues
- National Security and International Affairs Division, Military Operations and Capabilities Issues

Chairman and Ranking Minority Member of each of the following Congressional Committees and Subcommittees:

- 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 National Security, Committee on Appropriations
- House Committee on Government Reform and Oversight
- House Subcommittee on Government Management, Information, and Technology, Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Part III - Management Comments

Department of the Army Comments

DEPARTMENT OF THE ARMY
THE CENTER OF MILITARY HISTORY
1099 14TH STREET NW
WASHINGTON, DC 20005-3402

REPLY TO ATTENTION OF

DAMH-MDM (36-2b)

18 June 1997

MEMORANDUM THRU ~~THE DIRECTOR OF THE ARMY STAFF~~ 20/6/97
DIRECTOR OF THE ARMY STAFF JUN 2 0 1997
FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL (AUDITING)

SUBJECT: Audit Report on Management of the U.S. Army Center of Military History Exchange-For-Services Agreement (Project No. 5FJ-5024.04)

1. The Army's response to the subject draft audit report is enclosed at TAB A. The report (TAB B) was sent originally to the Commander, U.S. Army Materiel Command (AMC), for review and comment. The AMC transferred the action to the U.S. Army Center of Military History (CMH) for action as the office of primary responsibility.

2. Although the Army disagrees with a number of the specific findings and recommendations, we acknowledge shortcomings in the Center's administration of its exchange agreement with Southeastern Equipment Company, Inc. (SECO). Over the last six months, the U.S. Army Audit Agency, working with AMC, has conducted an extensive review of Center operations, including the exchange agreement. As a result of this review, the Army intends to implement detailed recommendations to improve the Center's business practices.

3. As you are aware, CMH has incurred a substantial liability to SECO under the exchange agreement. Based on our review, we believe that the correct amount owed is approximately $2.1M. While the internal Army review was pending, we suspended all exchange transactions. This action left CMH with no means to pay SECO under the exchange agreement and has caused an extreme hardship for SECO as well as its subcontractors and vendors. Now that the Army's review is complete, we believe, subject to final Secretarial approval, that CMH should be allowed to resume exchange transactions for the purpose of liquidating its obligations to SECO. For obvious reasons, however, we do not want to proceed if there is an unresolved disagreement with the DODIG regarding the amount owed. We therefore request that you review our responses to the various findings and recommendations and advise us soonest whether you concur in the Army's proposed approach.

4. This response has been coordinated with the following agencies:

a. AMCCG-CMH (COL Paige and Ms. Smith)

DAMH-MDM
SUBJECT: Audit Report on Management of the U.S. Army Center of Military History Exchange-For-Services Agreement (Project No. 5FJ-5024.04)

b. AMCCC-PA (LTC Hoburg), DAJA-AL (CPT Weedman), and SAGC (Mr. Castle).

c. SAAG-AFI (Mrs. Newman)

5. The point of contact for this action is Judson E. Bennett, Jr., Chief Curator, (202) 761-5373 or DSN 763-5373.

Encls

JOHN W. MOUNTCASTLE
Brigadier General, USA
Chief of Military History

2

Final Report Reference

Page 3

DODIG DRAFT REPORT
MANAGEMENT OF THE U.S. ARMY CENTER OF MILITARY HISTORY EXCHANGE-FOR-SERVICES AGREEMENT
(5FJ-5024.04)

FINDING: The CMH did not properly manage its "Exchange for Services" - 10 U.S.C. § 2572 agreement. Specifically the CMH did not make use of an outdoor storage area and underutilized three warehouses leased under the agreement. In addition, the CMH allowed SECO to store contractor-owned property in two of the warehouses, exchanged sixteen helicopters for less than fair market value under the agreement, and subsidized SECO operations by paying transportation costs on exchanges. These conditions occurred because the CMH:

leased $2.5 million of indoor and outdoor storage space based on the amount of excess property it expected to receive, rather than on approved transfers from DRMS and from Army commands that supplied property;

did not utilize less costly storage facilities for long-term storage of excess helicopters;

did not comply with Army procedures on property accountability and valuation for sixteen helicopters;

did not offset transportation costs incurred by the Government in shipping helicopters and other property to the storage facilities;

did not enforce billing and reporting provisions on $2.3 million of costs incurred under the "Exchange for Services – 10 U.S.C. 2572" agreement; and

did not establish a management control program to evaluate and report material weaknesses, as required by DOD Directive 5010.38.

As a result, we estimate that CMH overstated its liability to SECO by at least $1.1 million and undervalued the sixteen helicopters it exchanged with SECO by approximately $1 million.

1

Final Report Reference

DODIG DRAFT REPORT
MANAGEMENT OF THE U.S. ARMY CENTER OF MILITARY HISTORY EXCHANGE-FOR-SERVICES AGREEMENT
(5FJ-5024.04)

Pages 5-8 Revised

CMH leased $2.5 million of indoor and outdoor storage space based on the amount of excess property it expected to receive, rather than on approved transfers from DRMS and from Army commands that supplied property. [Reference pp. 3, 5-7 of Draft Report]

The Army concurs with this finding; however, it would be impractical to base storage requirements solely on approved equipment transfers from DRMS and from Army commands. CMH established only a portion of its storage requirements on the amount of excess property it expected to receive from other Army activities for future exchanges. Much of the other property to be stored was historical property received from museums and installations (such as Pueblo Army Depot) being closed due to BRAC, and from units being either reflagged or inactivated. The Center will have a continuing need to store some historical property. As a result of the USAAA audit and AMC oversight, the Center is reviewing and refining its storage requirements.

Pages 3, 9 Revised

CMH did not utilize less costly storage facilities for long-term storage of excess helicopters. [Reference pp. 3, 8 of Draft Report]

The Army does not concur with this finding because CMH did use the least costly storage facilities available. While the Center did not consider the Air Force location because the helicopter storage was to have been short-term only, it did consider several possible locations besides SECO, including ANAD, Navaho ANG Depot, and sites in Europe. CMH decided on SECO because the 10 U.S.C. 2572(b) exchange process allows the Army to obtain these storage services without expenditure of appropriated funds and the costs, including storage, transportation, and handling fees, were the cheapest of all sites considered. Also, use of a government facility such as AMARC would require that CMH incur more expensive appropriated fund transportation, handling, and utility charges, which are avoided through the section 2572(b) process. The Army believes that use of section 2572(b) authority is a prudent resourcing option and should be maximized, subject to incorporation of appropriate management controls. The USAAA, based on its recent audit of CMH, has made a number of specific recommendations that will ensure the exchange process is administered in a sound manner consistent with applicable law.

2

Final Report Reference

DODIG DRAFT REPORT
MANAGEMENT OF THE U.S. ARMY CENTER OF MILITARY HISTORY EXCHANGE-FOR-SERVICES AGREEMENT
(5FJ-5024.04)

CMH did not comply with Army procedures on valuation for sixteen helicopters (11 UH-1 and 5 OH-58) and undervalued these sixteen helicopters it exchanged with SECO by approximately $1 million. [Reference pp. 3, 10-11 of Draft Report]

Pages 3, 11-12 Revised

The Army does not concur with this finding. The CMH did not have an established valuation process; however, neither DOD nor the Army have any established procedures to value property for exchange transactions. The CMH process was at least as valid as that proposed by the DODIG because the DODIG based its finding on the UH-1's on a single DRMS sale of another UH-1. Likewise, the DODIG's finding on OH-58's is based on a DRMS sale of three other OH-58's. To the best of our knowledge, the DODIG did not examine or appraise the actual sixteen aircraft involved in CMH-to-SECO exchange. Given the considerable variation in condition of individual aircraft, we do not believe that any valid conclusions may be drawn on the basis on unrelated DRMS sales. We base this statement on the USAAA's recent experience in reviewing valuation of 18 other CMH helicopter exchanges. The USAAA found that the helicopter values varied widely depending on the age and condition of the primary aircraft components and on the different engine sizes and models – specifically ranging from $5,000 to $130,000. For this reason, we disagree with the DODIG's underlying methodology for this finding. The USAAA concluded that, although the process CMH used to value helicopters needed improvement for future transactions, the value assigned to the helicopters already traded to SECO was within a reasonable range.

In addition, the sixteen aircraft that are the subject of the DODIG finding have been transferred to SECO as partial payment under CMH's exchange agreement, and are no longer under DOD control. It is thus impracticable to conduct specific retroactive appraisals. For this reason, and in view of the absence of any generally prescribed method of valuation, the inherently subjective nature of the valuation process as well as USAAA's previous experiences in this area, we see no basis to contest valuation of these sixteen already-transferred aircraft.

CMH did not offset transportation costs incurred by the Government in shipping helicopters and other property to the storage facilities. [Reference pp. 3, 11 of Draft Report]

Pages 3, 12 Revised

The Army concurs with this finding. When CMH instructed SECO to transport the items in question, it did not intend to use this property to satisfy obligations under the SECO exchange agreement. Since 10 U.S.C. § 2572(b)(1)(C) authorizes exchanges for the purpose of obtaining "transportation services," and since the CMH-SECO exchange agreement is silent on the point, we believe there is no legal basis for the Army to claim a retroactive offset.

3

Final Report Reference

DODIG DRAFT REPORT
MANAGEMENT OF THE U.S. ARMY CENTER OF MILITARY HISTORY EXCHANGE-FOR-SERVICES AGREEMENT
(5FJ-5024.04)

Pages 3,6,14 Revised

CMH overstated its liability to SECO by at least $1.1 million. [Reference pp. 3, 12-13 of Draft Report]

The Army does not concur with this finding. The correct square footage is 697,280, not the 193,100 stated in the draft report. At CMH's request, SECO identified an outdoor storage area, and CMH personnel subsequently requested SECO to fence in this area for CMH use. This storage space was encompassed in tasking order number 94-01 of CMH's "Goods for Services" (GFS) agreement with SECO. Rates for this storage space were included in the basic GFS agreement and the subsequent annual amendments thereto. Although none of this documentation delineates the square footage that SECO provided, the area in question is not in dispute, and the Army has verified through a local government plat the acreage/square footage that CMH has been leasing. Accordingly, the Army does not believe the $1.1M downward adjustment recommended in the draft audit report is warranted. The Army recognizes shortcomings in the means by which CMH acquired this storage space. The USAAA has developed specific recommendations for improvement, and AMC will be working closely with CMH to improve its business practices.

Pages 5-8,14 Revised

CMH overstated its liability to SECO by an unspecified amount because it allowed SECO to use two of the warehouses leased under the exchange-for-services agreement without consideration. [Reference pp. 6, 13 of Draft Report]

The Army does not concur with this finding. SECO's use of this space did not conflict with CMH's usage. Also, the exchange agreement did not address SECO's use of the warehouse, and CMH obviously consented to the arrangement. We are unaware of any legal basis under which the Government could now claim an offset.

RECOMMENDATIONS AND ACTIONS TAKEN

Page 16 Revised

RECOMMENDATION 1. Army Materiel Command should assess the need for an exchange agreement with the Southeastern Equipment Company, Incorporated. As part of the assessment, thoroughly evaluate the availability and possible use of the Air Force Aerospace Maintenance and Regeneration Center for long-term storage of historic aircraft. [Reference p. 14 of Draft Report]

RESPONSE 1. The Army concurs with this recommendation. The Center is currently in the process, with AMC, of reassessing its storage requirements. The Center has

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Final Report Reference

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MANAGEMENT OF THE U.S. ARMY CENTER OF MILITARY HISTORY EXCHANGE-FOR-SERVICES AGREEMENT
(5FJ-5024.04)

considered other means for satisfying the need for storage and other services and concluded that the exchange agreement (goods-for-services) option meets its needs at the lowest cost provided that appropriate management controls are in place.

RECOMMENDATION 2. Army Materiel Command should recompute the Government's liability to the Southeastern Equipment Company, Incorporated, under the "Exchange for Services – 10 U.S.C. 2572" agreement, using fair market valuations and correct inventory records to value and document the helicopters that were transferred and to fully account for the transportation and storage costs that were incurred by the Government but benefited the Southeastern Equipment Company, Incorporated. [Reference p.14 of Draft Report]

Page 16 Revised

RESPONSE 2. The Army does not concur with this recommendation. During the USAAA audit, AMC worked with SECO, CMH, and USAAA to clear up documentation shortcomings and to clarify commitments made between the Center and SECO. While we agree that the previous process and documentation were inadequate, we believe that the Center's liability is correctly stated. Moreover, in view of the fact that SECO entered into the agreement with CMH in good faith and has provided services to the Army, we believe it is in the Government's best interest to pay amounts owed in accordance with the agreement as expeditiously as possible.

RECOMMENDATION 3. Army Materiel Command should require the Commander/Chief of Military History to establish a management control program as required by DOD Directive 5010.38. [Reference p. 14 of Draft Report].

Page 17 Revised

RESPONSE 3. The Army concurs with this recommendation. The Army will establish a management control program.

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Audit Team Members

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