

AD-A246 400



2

NAVAL POSTGRADUATE SCHOOL

Monterey, California



THESIS

DTIC
ELECTE
FEB 21 1992
S B D

ACCOUNTING FOR THE COMMERCIAL USE
OF GOVERNMENT FURNISHED PROPERTY

by

David F. Baucom

June 1991

Thesis Advisor:

Rodney F. Matsushima

Approved for public release; distribution is unlimited

92-04341



2 19 079

Unclassified

SECURITY CLASSIFICATION OF THIS PAGE

REPORT DOCUMENTATION PAGE				Form Approved OMB No 0704-0188	
1a REPORT SECURITY CLASSIFICATION UNCLASSIFIED			1b RESTRICTIVE MARKINGS		
2a SECURITY CLASSIFICATION AUTHORITY			3 DISTRIBUTION/AVAILABILITY OF REPORT Approved for public release; distribution is unlimited.		
2b DECLASSIFICATION/DOWNGRADING SCHEDULE					
4 PERFORMING ORGANIZATION REPORT NUMBER(S)			5 MONITORING ORGANIZATION REPORT NUMBER(S)		
6a NAME OF PERFORMING ORGANIZATION Naval Postgraduate School		6b OFFICE SYMBOL (If applicable) Code AS	7a NAME OF MONITORING ORGANIZATION Naval Postgraduate School		
6c ADDRESS (City, State, and ZIP Code) Monterey, CA 93943-5000			7b ADDRESS (City, State, and ZIP Code) Monterey, CA 93943-5000		
8a NAME OF FUNDING/SPONSORING ORGANIZATION		8b OFFICE SYMBOL (If applicable)	9 PROCUREMENT INSTRUMENT IDENTIFICATION NUMBER		
8c ADDRESS (City, State and ZIP Code)			10 SOURCE OF FUNDING NUMBERS		
			PROGRAM ELEMENT NO	PROJECT NO	TASK NO
					WORK UNIT ACCESSION NO
11 TITLE (Include Security Classification) ACCOUNTING FOR THE COMMERCIAL USE OF GOVERNMENT FURNISHED PROPERTY					
12 PERSONAL AUTHOR(S) Baucom, David F.					
13a TYPE OF REPORT Master's Thesis		13b TIME COVERED FROM _____ TO _____		14 DATE OF REPORT (Year, Month, Day) June 1991	
15 PAGE COUNT 142					
16 SUPPLEMENTARY NOTATION The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government					
17 COSATI CODES			18 SUBJECT TERMS (Continue on reverse if necessary and identify by block number)		
FIELD GROUP SUB-GROUP			Government Furnished Property; Property Administration; Property Management		
19 ABSTRACT (Continue on reverse if necessary and identify by block number) One area not identified by the Defense Management Review currently in progress is accountability for the commercial use of the Government Furnished Property located in Defense contractors' facilities. This study focused on this issue to determine if the Department of Defense should strengthen its accounting for contractors' use of Government Furnished Property on commercial work. The results of interviews with 50 Government and contractor Property Administrators at headquarters, field level activities, and contractors' facilities are reported. It was concluded that the current accounting procedures utilized by Defense agencies involved with contractors using Government Furnished Property for commercial work are inadequate and 15 recommendations are presented to correct these accounting deficiencies.					
20 DISTRIBUTION/AVAILABILITY OF ABSTRACT ☒ UNCLASSIFIED/UNLIMITED ☐ SAME AS RPT ☐ DTIC USERS			21 ABSTRACT SECURITY CLASSIFICATION Unclassified		
22a NAME OF RESPONSIBLE INDIVIDUAL Rodney F. Matsushima			22b TELEPHONE (Include Area Code) (408) 646-2052		22c OFFICE SYMBOL Code 54 Sx

DD Form 1473, JUN 86

Previous editions are obsolete

SECURITY CLASSIFICATION OF THIS PAGE

S/N 0102-LF-014-6603

Unclassified

Approved for public release; distribution is unlimited.

Accounting for the Commercial Use
of Government Furnished Property

by

David F. Baucom
Lieutenant, Supply Corps, United States Navy
B.S., Auburn University, 1981

Submitted in partial fulfillment
of the requirements for the degree of

MASTER OF SCIENCE IN MANAGEMENT

from the

NAVAL POSTGRADUATE SCHOOL

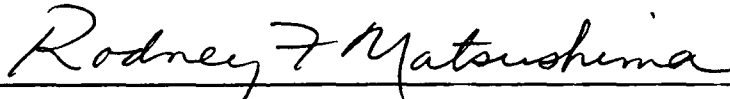
June 1991

Author:



David F. Baucom

Approved by:



Rodney F. Matsushima, Thesis Advisor



David V. Lamm, Second Reader



David R. Wipple

Department of Administrative Sciences

ABSTRACT

One area not identified by the Defense Management Review currently in progress is accountability for the commercial use of the Government Furnished Property located in Defense contractors' facilities. This study focused on this issue to determine if the Department of Defense should strengthen its accounting for contractors' use of Government Furnished Property on commercial work. The results of interviews with 50 Government and contractor Property Administrators at headquarters, field level activities, and contractors' facilities are reported. It was concluded that the current accounting procedures utilized by Defense agencies involved with contractors using Government Furnished Property for commercial work are inadequate and 15 recommendations are presented to correct these accounting deficiencies.



Accession For	
NTIS GRA&I	☒
DTIC TAB	☐
Unannounced	☐
Justification _____	
By _____	
Distribution _____	
Availability Codes	
Dist	Avail and/or Special
A-1	

TABLE OF CONTENTS

I.	INTRODUCTION	1
A.	GENERAL INFORMATION	1
B.	OBJECTIVE OF THE RESEARCH	2
C.	SCOPE AND LIMITATIONS OF THE STUDY	2
D.	METHODOLOGY	3
E.	ORGANIZATION OF THE STUDY	4
II.	DEPARTMENT OF DEFENSE ACCOUNTING FOR GOVERNMENT FURNISHED PROPERTY	6
A.	BACKGROUND	6
1.	Government Property	6
2.	Historical Perspective	9
B.	APPLICABLE ISSUES	10
1.	Why the Department of Defense Provides Property	10
2.	The Property Control System	11
3.	Liability for Lost or Damaged Government Furnished Property ..	12
4.	Ownership of Government Furnished Property at Contract Termination	12

C.	CURRENT PROBLEMS	13
1.	Lack of Accountability	13
2.	DOD's Continuance in Providing Government Furnished Property	15
3.	Inventory Control Systems	17
D.	CORRECTIVE INITIATIVES	20
1.	Initiatives to Improve Accountability	20
2.	Initiatives to Decrease the Property Provided	23
3.	Initiatives to Improve Inventory Control Systems	24
E.	SUMMARY	25
III.	THE POLICY REGARDING CONTRACTOR USE OF GOVERNMENT FURNISHED PROPERTY FOR COMMERCIAL WORK	27
A.	THE POLICY REGARDING COMMERCIAL USE OF GOVERNMENT FURNISHED PROPERTY	27
1.	Accounting for the Commercial Use of Real Property	28
2.	Accounting for the Commercial Use of Plant Equipment	29
3.	Accounting For the Commercial Use of Special Tooling and Special Test Equipment	30
B.	NEUTRALIZING COMPETITIVE ADVANTAGE	31
1.	The General Policy	31
2.	Additional Factors to Consider	31
3.	Residual Value of Special Tooling and Special Test Equipment ..	32
4.	Solicitation Requirements	33
C.	SUMMARY	33

IV.	AUDITS OF CONTRACTORS UTILIZING GOVERNMENT FURNISHED PROPERTY FOR COMMERCIAL WORK	35
A.	REPORTS BY THE U.S. GENERAL ACCOUNTING OFFICE	35
B.	REPORTS BY THE DOD INSPECTOR GENERAL	37
C.	REPORTS BY THE ARMY AUDIT AGENCY	39
D.	REPORTS BY THE NAVAL AUDIT SERVICE	40
E.	REPORTS BY THE AIR FORCE AUDIT AGENCY	41
F.	SUMMARY	42
V.	SURVEY RESULTS	44
A.	INTRODUCTION	44
B.	THE RESPONSES	45
1.	Question One	45
a.	Government Responses	45
b.	Contractor Responses	47
2.	Question Two	48
a.	Government Responses	48
b.	Contractor Responses	50
3.	Question Three	52
a.	Government Responses	52
b.	Contractor Responses	53

4. Question Four	55
a. Government Responses	55
b. Contractor Responses	56
5. Question Five	57
a. Government Responses	57
b. Contractor Responses	58
6. Question Six	59
a. Government Responses	59
b. Contractor Responses	60
7. Question Seven	62
a. Government Responses	62
b. Contractor Responses	63
8. Question Eight	64
a. Government Responses	64
b. Contractor Responses	65
9. Question Nine	66
a. Government Responses	66
b. Contractor Responses	67
10. Question Ten	69
a. Government Responses	69
b. Contractor Responses	70

11. Question Eleven	71
a. Government Responses	71
b. Contractor Responses	72
12. Question Twelve	72
a. Government Responses	73
b. Contractor Responses	73
13. Question Thirteen	74
a. Government Responses	74
b. Contractor Responses	75
14. Question Fourteen	76
a. Government Responses	76
b. Contractor Responses	76
15. Question Fifteen	76
a. Government Responses	77
b. Contractor Responses	77
16. Question Sixteen	78
a. Government Responses	78
b. Contractor Responses	80

C.	DISCUSSION OF THE DATA	81
1.	Effectiveness of the Government's Policy	81
2.	Contract Provisions	82
3.	Additional Training	83
4.	Automation of Contractors' Records	83
5.	Contract Close-out Procedures	84
6.	Visibility in Small Contractor and Subcontractor Facilities	84
7.	Effects of Manpower Reduction	85
8.	Specific Accounting Problems	86
D.	SUMMARY	87
VI.	CONCLUSIONS, RECOMMENDATIONS, AND AREAS FOR ADDITIONAL RESEARCH	88
A.	GENERAL	88
B.	CONCLUSIONS	89
C.	RECOMMENDATIONS	92
D.	AREAS FOR ADDITIONAL RESEARCH	97
	APPENDIX A	99
	APPENDIX B	120
	APPENDIX C	122
	APPENDIX D	126

LIST OF REFERENCES	129
INITIAL DISTRIBUTION LIST	131

I. INTRODUCTION

A. GENERAL INFORMATION

As the United States emerges victoriously from its declared war with Iraq and the nation once again focuses on cost cutting efforts to reduce its enormous Federal budget deficit, it appears the current reduction in defense spending will continue indefinitely. Central to the Defense Department's cost cutting efforts is its Defense Management Review currently in progress. In this self-evaluation, the Defense Department is examining every facet of its managerial controls over the assets within its purview.

When awarding procurement contracts to businesses, Defense Procurement Officers often provide Government-owned material, machinery, or other property for the contractors to use on those contracts. Contracting Officers provide this property for numerous reasons and stipulate that the contractor will be responsible for accounting for this Government Furnished Property while it is located in their facilities.

Oftentimes, the Government Furnished Property that the contractors are using to produce Government end items can also be utilized by the contractor to produce items the contractor sells in the commercial marketplace. In these cases, it is the contractor's responsibility to obtain written authorization from the Government Contracting Officer to use these Government assets for commercial purposes and, if directed by the Government Contracting Officer, to pay a rental fee to the Government for using the property for non-Government purposes.

As the Defense Department is currently evaluating cost cutting methods and strengthening managerial controls over its assets, an interesting area for examination is its accountability for the commercial use of the Government Furnished Property in the custody of its contractors.

B. OBJECTIVE OF THE RESEARCH

The purpose of this study is to determine if the Defense Department should strengthen its accounting for contractors' use of Government Furnished Property on commercial work.

Given this objective, the following subsidiary questions are also addressed:

1. What is the Department of Defense policy regarding commercial use of Government Furnished Property and how effective has this policy been?
2. To what extent does the use of Government Furnished Property give the contractor an unfair advantage in the commercial market?
3. What key areas of contractor use of Government Furnished Property for commercial work have been identified by agency audits as needing improvement?
4. Is the Department of Defense's accounting sufficient to assure that contractors are providing adequate stewardship over the use of Government Furnished Property for commercial work?
5. What modifications should be made to the Department of Defense policy or to the enforcement mechanisms?

C. SCOPE AND LIMITATIONS OF THE STUDY

This study involves a detailed assessment of the effectiveness of the current Department of Defense policy of accounting for Defense contractor use of Government-

owned property for commercial purposes. The study involves an analysis of Government and commercial organizations' accounting for Government Furnished Property, and recommendations for improving that accounting. This study is not limited to the size of Defense contractors, a specific type of contracts, or to a specific type of industry. The researcher does not acquire data concerning management of Government-owned property above the Defense Plant Representative Office (DPRO) organizational level.

D. METHODOLOGY

The research data were collected by means of extensive literature search and telephone interviews with personnel at headquarters, field level activities, and contractors' facilities. The literature, consisting of professional journal articles, current regulations and directives, and Government audit reports, was accumulated through the Naval Postgraduate School Library, the *Defense Logistics Studies Information Exchange* (DLSIE), the Defense Technical Information Center (DTIC), the Office of Senator John Glenn (D-Ohio), and several DOD offices responsible for property administration.

Telephone interviews were held with DOD officials responsible for establishing property policy and with 50 Government and contractor Property Administrators at the field level involved in managing Government Furnished Property. All of the Government Property Administrators who were interviewed were in the GS-1103 series and at the GS-11/12/13 grade level. The average property administration experience of the contractor Property Administrators interviewed exceeded 20 years. The interviews with all Property Administrators were held on a nonattribution basis in order to obtain candid responses and

honest evaluations of the current accountability for Government-owned property in contractors' facilities.

The central postulate to this study is that experienced professionals in the field of property administration are best able to determine whether current procedures are adequate in accounting for the commercial use of Government Furnished Property. The conclusions and recommendations are, therefore, derived primarily from their points of view.

There is no other research known in the area of accounting for the commercial use of Government Furnished Property.

E. ORGANIZATION OF THE STUDY

The next chapter provides background information and a historical perspective of Government Furnished Property, describes the issues which are relevant to accounting for the commercial use of this property, examines current accountability problems, and explores initiatives to correct those problems.

Chapter III examines the Defense Department's policies regarding the commercial use of Government-owned property and the neutralizing of a contractor's competitive advantage when using Government Furnished Property for commercial purposes.

Chapter IV reviews current audit reports on contractors utilizing Government Furnished Property for commercial purposes. These audits were conducted by the General Accounting Office, the Department of Defense Inspector General, and audit agencies of the Army, Navy, and Air Force.

Chapter V presents the responses of 50 professional Property Administrators on the 16 questions the researcher posed to them during telephone interviews held in February 1991.

The final chapter discusses the results of this study, draws conclusions based upon the research data, and makes specific recommendations resulting from the research effort. The chapter concludes with recommended areas for additional research.

II. DEPARTMENT OF DEFENSE ACCOUNTING FOR GOVERNMENT FURNISHED PROPERTY

The purpose of this chapter is to explore the current problems faced by the Department of Defense (DOD) in accounting for the property furnished to its contractors and to focus on specific initiatives to improve control. In accomplishing this objective, the evolution of the accountability problems is examined, significant issues involving Government Property are clarified, the current problems are presented, and the current initiatives to correct those problems are discussed.

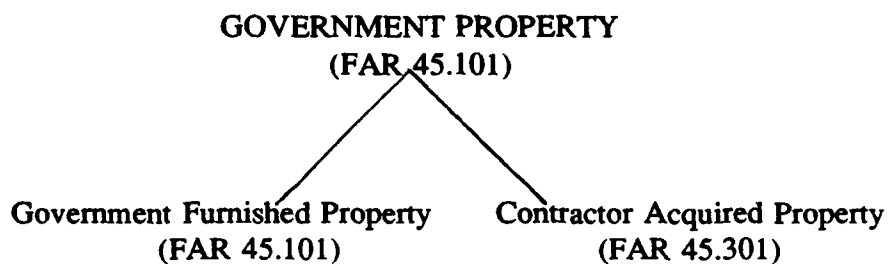
A. BACKGROUND

To understand the implications of the GFP problems faced by DOD today, it is first necessary to define GFP and understand the historical perspective of those problems.

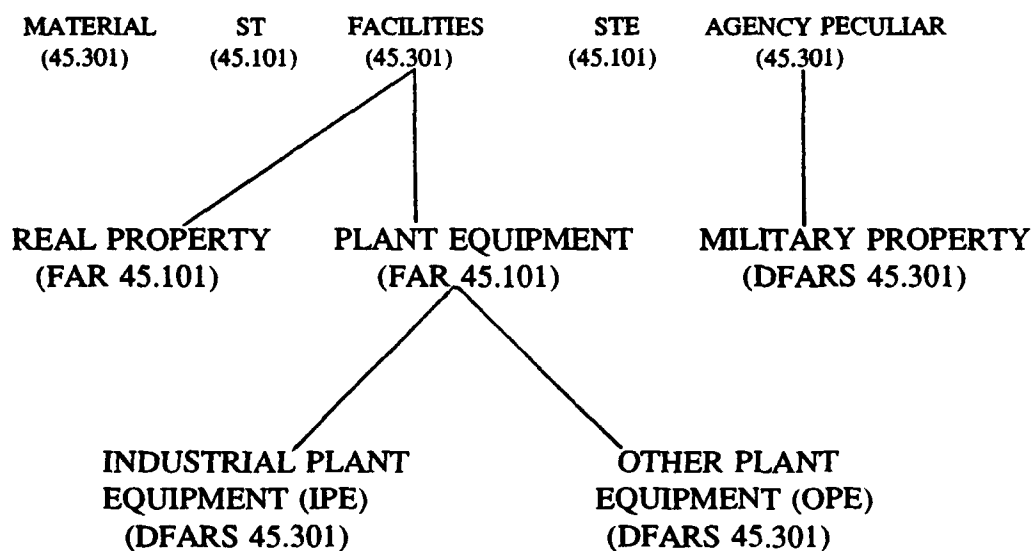
1. Government Property

The two ways the Government may furnish property to its contractors is either directly from its warehouses or production facilities, or by allowing the contractor to acquire the property through his normal purchasing channels. When the Government furnishes it directly from its own stores, it is called Government Furnished Property (GFP). When it is furnished through the contractor by commercial purchase, it is called Contractor-Acquired Property (CAP). When both of these categories are handled together, they are covered under the general heading of "Government Property." Figure 2.1 illustrates the interrelationships of these categories.

METHOD OF ORIGIN



FIVE CATEGORIES OF GOVERNMENT PROPERTY



Source: [Ref. 1:p. 33]

Figure 2.1 The Five Categories of Government Property

"Material" is classified as items which will eventually become part of the end product and consumed in the production process. Contractual issues involve timeliness of delivery, suitability for intended use, and accounting procedures [Ref. 3:p. 168]. Material can be delivered by the Government to the contractor, the contractor can order the material directly from the supply system by citing his DOD Address Activity Code (DODAAC), or the material may be purchased by the contractor on the open market.

"Special Tooling" (ST) includes dies, jigs, molds, patterns, taps, gauges, and other specialty items which may be used for fabrication. They are only used for producing a specific end item or performing a specific service. If the tool can be used to build a common part, then it cannot be classified as a special tool. [Ref. 3:p. 46]

"Facilities" are industrial property for production, repairs, maintenance, test, or evaluation. This category of property can be classified as: (1) Real estate - buildings or property; (2) Industrial Plant Equipment (IPE) - machines with an acquisition cost of \$5,000 or more that are used to cut, grind, shape, or abrade; or (3) Other Plant Equipment (OPE) - machinery that is less expensive than IPE, but is used for the same purposes [Ref. 2:p. 46]. Examples of facilities include military test sites, machine tools, test equipment, furniture, and vehicles. Contractual issues involve authorization for use, access to premises, scheduling, and coordinating work for all users [Ref. 3:p. 167].

"Special Test Equipment" (STE) includes specifically designed integrated units which are fabricated to facilitate tests in the performance of a contract. The definition was expanded in August 1988 to ensure that connecting common items (oscilloscopes, for

example) that can only accomplish special testing are STE as well [Ref. 3:p. 46].

Contractual issues involve questions of ownership and equity. [Ref. 3:p. 169]

"Agency Peculiar Property" is unique to the mission of the Government agency which provides the property. This property specifically excludes Government facilities, material, ST, and STE. Examples of Agency Peculiar Property include space vehicles, weapons, or other equipment acquired by the services for specific applications. Contractual issues involve preservation, protection, and accountability for this property. [Ref. 3:pp. 169-170]

2. Historical Perspective

The Government has been providing property to its contractors since at least 1884. In that year, the Army attempted to reduce the contract price for muzzle loaded rifles by providing the frames for holding the sand molds for the barrel castings. [Ref. 4:p. 167]

In the late 1930s, with the possibility of the country going to war, the Government asked its contractors to support requirements for rapid mobilization. Because private companies were unable or unwilling to make the huge investments required, the Government provided the plants and equipment for its contractors to operate. Subsequent Defense contractors expected the same treatment.

In 1949, the Congress passed the Federal Property and Administrative Services Act (40 U.S.C. 471 et seq.) which, as amended, gives the General Services Administration (GSA) the exclusive right, power, and duty to deal with all Government Property in the

Federal establishment. The GSA subsequently re delegated this authority to the Department of Defense (DOD) for property in its own operational activities.

The DOD utilized this authority and provided Government Property to its contractors as a leverage for reducing contract prices (just as the Army had done in 1884). Until the early 1960s, DOD had furnished the plants, machinery, tools, and much of the working capital required by Defense contractors [Ref. 5:p. 5]. Studies indicate that during the period from 1957 - 1961, GFP was estimated at 105% of total Defense contractor fixed assets [Ref. 6:p. 147]. Establishing accountability for this Government Property continues to challenge procurement officials.

B. APPLICABLE ISSUES

The four issues applicable to accounting for contractor use of GFP are: (1) why the DOD would provide Government Property to its contractors; (2) the Property Control System; (3) ownership of GFP at contract termination; and (4) liability for lost or damaged property.

1. Why the Department of Defense Provides Property

Normally it is the suppliers' responsibility to acquire the property it needs to perform a contract. However, because of the Government's right to terminate for convenience, its right to seek independent competition for every procurement, and the fact that most items it buys have little commercial value, contractors may hesitate to make long term investments or to amortize costs of specific property since future contracts against which to amortize are not guaranteed. [Ref. 3:p. 170]

Additional reasons why the Government may provide property to a contractor include: (1) to ensure proper security; (2) to encourage standardization; (3) to obtain a better price during negotiations; (4) to support small business concerns; (5) to better allocate scarce resources; (6) to broaden the industrial base; (7) to increase competition; and (8) to update improvements in manufacturing processes. [Ref. 7:p. 14]

Before a contractor can utilize GFP on a contract, his property control system must be reviewed and approved by a Government Property Administrator.

2. The Property Control System

The contractor is responsible for maintenance, utilization, protection, and care of the Government Property in his possession. Title 10 U.S. Code 2701(a) requires records of fixed property, installations, and major equipment. The Property Administrator, as the Procuring Contracting Officer's (PCO's) representative, is responsible for ensuring the contractor has an adequate system for accounting for all Government Property in his facility. The two clauses located in the Federal Acquisition Regulation (FAR) paragraphs 52.245-2 and 52.245-5 specifically require the contractor to establish a property control system in accordance with FAR 45.5. Terence M. Cleary identifies these responsibilities:

The Contracting Officer must be satisfied that the contractor's property control system provides adequate protection for GFP in the contractor's possession. The contractor's responsibilities include receipt of GFP; reporting shortages, loss, damage, or destruction; maintenance of control records for GFP; records of pricing information; identification of GFP; segregation of GFP from contractor-owned property; inventories; and, general care and maintenance. [Ref. 8:p. 2]

3. Liability for Lost or Damaged Government Furnished Property

In sealed bid or competitive negotiated contracts the contractor is liable for all loss or damage except for normal wear and tear and property consumed in contract performance. In all other contracts, the Government acts as a self-insurer of any Government Property that is in the possession of contractors [Ref. 7:pp. 14-16]. If not for this policy, the cost of the contractor's insurance would increase the price of fixed-price contracts and would be an allowable cost under cost-type contracts.

4. Ownership of Government Furnished Property at Contract Termination

Whether the contractor or the Government retains title to GFP after contract completion depends upon the type of contract and the clauses included in the contract. The three commonly used GFP clauses are: (1) Government Property (cost-reimbursement, time-and-material, or labor hour contracts); (2) Government Furnished Property (fixed-price contracts); and (3) the Special Tooling Clause.

The Government Property Clause for cost-type contracts (FAR 52.245-5) states that title to all property acquired by the contractor and all property furnished by the Government under these types of contracts will be vested in the Government.

The Government Property Clause for fixed-price contracts (FAR 52.245-2) states that the Government will retain title to all GFP purchased for the contract if the contractor was directed to purchase the property and the contract states that the Government will reimburse the contractor. The contract could list the property as a Contract Line Item (CLIN), in the Statement of Work, or in another section of the contract. [Ref. 2:p. 47]

The Special Tooling (ST) clause (FAR 52.245-17) gives the Government the right to title of the property at contract completion. It states that the contractor must provide the PCO a complete list of all ST required in a contract when the majority of the work has been completed. Upon receiving this list, the PCO provides disposition instructions to the contractor for the property. These instructions may include: (1) the Government taking possession; (2) the contractor purchasing the property; (3) the contractor selling the ST for a Government account; or (4) the contractor disposing the property. [Ref. 2:p. 48]

If the ST was also used in commercial production, the contractor may prefer to purchase it from the Government, use the tool "rent free" on an existing Government contract, or pay a monthly rent to the Government [Ref. 2:p. 48].

C. CURRENT PROBLEMS

Three problems are addressed within the scope of the issues presented: (1) lack of accountability; (2) DOD's continuance in providing GFP; and (3) inventory control systems.

1. Lack of Accountability

Accountability problems abound in the Government's control of GFP. Countless reviews of management systems repeat the same findings: (1) lack of recording utilization for Government owned plant equipment; (2) failure of the contractors to report equipment that becomes idle; (3) poor maintenance practices; (4) unauthorized use of property for commercial purposes; (5) failure of the Government to corroborate

commercial use and rental charges; (6) loss of traceability of GFP in the contractor's plant that eventually reverts to contractor ownership (abandoned in place); (7) DOD procuring duplicate material or equipment for new contracts instead of relocating what it already owns; and (8) the Government buying property from the contractor for which it already has title. [Ref. 9:p. 67]

Most property management accountability problems arise when the sources of property are mixed, or there are large numbers of items involved, or possession is transferred among customers, the prime contractor, subcontractors, and co-contractors [Ref. 3:pp. 165-171]. Also, because there is no real enforcement mechanism (for example, extra money from the Government) to establish and abide by a good property control system, the contractors simply are not motivated to improve control and accountability [Ref. 9:p. 66].

In 1978 it was estimated that the value of Government Property in defense contractors' possession was \$30 billion [Ref. 9:p. 64]. Despite attempts to reduce the amount of GFP in the system, in 1986 it was estimated that contractors had approximately \$45 billion [Ref. 10:p. 6]. On September 30, 1989 the total amount of GFP estimated in the new DOD accounting system was \$64.4 billion [Ref. 11].

The latest figure is expected to be the most accurate because: (1) some contractors did not submit data to include in the 1986 figure; (2) only facilities were counted prior to 1986; (3) contractors' records did not, always, accurately account for the Government Property in their possession; and (4) DOD implemented the "DOD Property in the Custody of Contractors" system in 1986. [Ref. 11]

This new system, as specified in DFARS 245.505-14, requires contractors to utilize DD FORM 1662 in recording the beginning balance, additions and deletions, and the ending balance of GFP in their possession and they are required to submit this information to DOD by September 30 each year. Although this new reporting requirement is improving DOD's accounting for its property, the Defense Department still relies solely upon the contractors to account for the GFP in their possession. [Ref. 11]

During the March 21, 1988 Senate Hearing before the Committee on Government Affairs, the Committee Chairman, Senator John Glenn, likened the requirement that contractors maintain their own GFP inventory records to commercial business:

This is a little bit like a situation in which I owned a building supply company here in the Washington area. My company could supply everything you would need to build a house. I decided to contract with some builders to build five houses for me.

Now, I tell these builders I will supply all the material they need to build the houses. But, I don't even inventory what they take out. They drive truck after truck up to the warehouse. They take lumber, bricks, mortar, door hinges, doors, pipe, everything that goes into building five homes. And I don't even check what they have.

Occasionally I call the contractors, and I say, how is your inventory coming over there? What do you have in stock? I leave it completely up to them to tell me what they have. I don't even check it.

Now, we would think that was the most ludicrous business situation that we could possibly imagine, and it would be. Yet that is in effect what we are doing with our Government contracts too many times. [Ref. 12:p. 5]

2. DOD's Continuance in Providing Government Furnished Property

Four reasons why DOD has failed to minimize the amount of property it provides to contractors are: (1) the exception clauses in the FAR are too broad; (2) both DOD and Defense contractors believe that capital investment in Defense production is

unprofitable; (3) DOD sales of facilities and equipment have been limited; and (4) DOD has provided too little guidance to its procurement officials. [Ref. 13:p. 8]

First, the exception clauses in the FAR are too broad and allow PCOs the ability to use property as a leverage to reduce initial contract prices. Phrases in the applicable FAR references such as "in the best interest of the Government" provide the assistance needed during negotiations for the PCO to meet negotiating objectives utilizing GFP to reduce contract prices.

In his testimony before Senator Glenn's Committee Hearing in March 1988, Mr. Frank C. Conahan, Assistant Comptroller General (National Security and International Affairs Division) of the General Accounting Office called for changes in the FAR and DFARS which limit the provisioning of GFP. He testified:

In our June 1986 report on GFE we noted that the FAR criteria was very vague and that this allowed Government officials to provide almost any sort of equipment that they decided was needed under the contract including such items as office furniture, vehicles, and personal computers.

In our report on Government Material we found a similar situation. Again, Government officials routinely provided material to contractors under the presumption that it was inherently less costly and troublesome for the Government to provide the material than for contractors to buy it. Material provided in this fashion included such readily available commercial items as paint, lumber, office and automotive supplies, and videotapes. [Ref 12:pp. 155-156]

Mr. Conahan's testimony is reprinted in its entirety in Appendix A.

Second, both DOD and defense contractors believe that capital investment in defense production is unprofitable, despite recent studies proving that sales to DOD on average are substantially more profitable than commercial sales [Ref. 13:p. 2]. For example, a 1985 Navy study of profits at 22 major defense contractors concluded:

The contractors made more than twice as much profit on Government work as on commercial business when their gains were measured against what they had invested in plants and other assets. [Ref. 14:p. 2]

Third, sales of Government-owned facilities and equipment have been limited. In April 1986, the Services had 64 Government-Owned-Contractor-Operated (GOCO) plants containing GFP valued at \$2.7 billion in addition to plant equipment valued at \$400 million in over 300 Contractor-Owned-Contractor-Operated plants. [Ref. 13:p. 7]

Sixteen years earlier, the Assistant Secretary of Defense (Installations and Logistics) issued a policy statement which directed the Services to "phase-out" all Government owned facilities, including IPE and OPE in the possession of contractors over a five year period. This policy created considerable controversy and was reduced to a "phase-down" policy one year later [Ref.13:p. 4]. They are still phasing down today!

Fourth, DOD has provided too little guidance to its procurement officials on the selling of "nonexcess" property to its contractors. In many cases, the defense procurement officials are delegating their oversight and review responsibilities to the contractor. The contractor is determining the quantity and types of property to dispose of, acquire, or retain. Some contractors ignore established controls for the approval of GFP, or they bypass established acquisition procedures altogether. [Ref. 13:p. 8]

3. Inventory Control Systems

Material inventory is typically the second largest category of assets on a production contractor's balance sheet and is exceeded only by the value of the physical facilities and equipment [Ref. 15:p. 42]. Inventory carrying costs are the expenses incurred by a contractor because of the volume of material inventory carried.

These costs include obsolescence, deterioration, taxes, insurance, storage, capital, and transportation costs [Ref. 16:p. 52]. The value of inventory carrying costs vary from company to company and can range from 20% to 40% of average inventory value [Ref. 17:p. 441].

These carrying costs, charged to Government contracts through indirect cost allocations, are estimated to cost the Government millions of dollars annually. Manufacturers have always been concerned with having enough inventory on hand to produce their product. Balancing the conflicting goals of having the inventory on hand with minimizing carrying costs can have an enormous impact on a firm's profits. The company's inventory control system is the tool for reconciling these goals.

Material Requirements Planning (MRP), a system of ordering, controlling, and utilizing inventory, is one tool used by industry to manage the amount of material on hand at any given time. However, there are significant problems with contractors utilizing MRP systems on Government contracts. In 1987, at a Hearing before the Readiness Subcommittee of the House Committee on Armed Services, Representative Dan Daniel accurately stated:

Defense contractors have made hundreds of millions of dollars because the automated [MRP] systems do not comply with existing procurement regulations. [Ref. 18:p. 1]

These systems run afoul of the procurement regulations because they work as though material is not dedicated to any one production order. The MRP systems are premised on the fact that material is available for the first priority requirement regardless of whether the material was bought for a Government contract or a civilian contract. The

Government regulations, on the other hand, are based on the premise that materials should be purchased specifically for the Government contract, identified for that contract, and billed on the basis that it will remain on that contract. [Ref. 18:p. 7]

During this 1987 Hearing, the Director of the Defense Contract Audit Agency (DCAA), Mr. William H. Reed, estimated that Defense contractors had overcharged Defense contracts by \$700 million as a result of MRP deficiencies [Ref. 18:p. 8]. He continued:

At one location, we identified \$376 million of inventory which is not identified to any specific contract requirement. So, this is, in effect, inventory the company has that is not identified to any requirement, and the question is how could this inventory be generated in a system which is supposed to minimize inventory? Where did it come from? Who paid for it? Was it billed to the Government? Is it Government Property, or is it contractor property? We cannot answer any of those questions right now. [Ref. 18:pp. 8-9]

Mr. Reed further stated that there were numerous examples of Defense contractors using inventory paid for by the Government on commercial work and not paying the Government back for the inventory. He also testified that there were examples of contractors using inventories either provided by the Government or charged to the Government on commercial work, and then charging the Government for replacing that inventory at a higher cost than what it originally cost. This amounts to double-billing the Government for unauthorized use of Government Property. [Ref. 18:p. 5]

D. CORRECTIVE INITIATIVES

This section addresses the current initiatives to correct the previously described problems of accountability, DOD's continuance in providing GFP to its contractors, and inventory control systems.

1. Initiatives to Improve Accountability

DOD continues to take actions to reduce its GFP and improve management controls and accountability of GFP. On April 26, 1986 the House Committee on Government Operations recommended that the Secretary of Defense: (1) place responsibility for coordinating all actions for improving the management of and accounting for GFP, in one adequately staffed central office; (2) determine and request the additional investment in personnel, training, accounting, and management information resources necessary to ensure proper enforcement of the provisions of defense contracts in accordance with the terms of the FAR; and (3) speed up current efforts to install appropriate accounting controls over GFP. [Ref. 13:p. 12]

In response to the committee's recommendations, Secretary of Defense, Casper W. Weinberger directed DOD components to: (1) dispose of old, obsolete, and nonessential Government Property; (2) reduce the amount of Government Property in the possession of contractors; (3) bring a halt to the continuing increase of new GFP going to contractors; (4) eliminate the practice of routine transfer of Government Property from one contract to another; (5) identify plants and equipment that are considered essential for Government ownership; (6) stop the practice of storing inactive property unless

specifically justified as essential for the defense mission; and (7) improve property accountability records and accounting systems to provide improved control and management oversight [Ref. 19:p. 2]. These efforts are continuing.

Shortly after his inauguration, President Bush announced the establishment of the Defense Management Review (DMR) to identify economies and efficiencies within DOD. As a result of this comprehensive review, DMR Decision 933 (Accounting for GFM) and DMR Decision 995 (Consolidation of IPE) are currently being investigated. [Ref. 11]

Also, the Government Property Council was established in 1987 as a result of the 1986 Congressional Hearings' recommendations. During the 1988 Senate Hearings on GFP provided to DOD contractors, the Under Secretary of Defense for Acquisition, Mr. Robert B. Costello, listed three purposes for the establishment of the Property Council: (1) to review and monitor the Services' performance on key Government Property issues; (2) to ensure policies are in place; and (3) to ensure the record keeping is accurate and meets DOD requirements. [Ref 12:p. 44]

One initiative of the Council was for each Service to set up its own management control system (Management Control Activity (MCA)) to control contractor access to the Service's supply system. According to Ms. Mary Jo Johnson of the Office of the Assistant Secretary of the Navy (Research, Development, and Acquisition), beginning in fiscal year 1991 all Services will require contractors to reference MCAs on requisitions of GFM through the DOD supply system. [Ref. 20]

Another initiative of the Government Property Council is to improve accountability for GFM on DOD financial statements. According to Mr. David Steensma, Director of Contract Management, Office of the Department of Defense Inspector General, most DOD contractors have not been accounting for GFM after it moves from contractor stores inventory to work-in-process inventory. All GFM in the contractor's possession should be listed as a contingent asset on the DOD financial statements [Ref. 21]. As a result of this new initiative, the DFARS will be changed by the end of 1991 to require Defense contractors to account for all GFM in the contractor's facility [Ref. 20].

It is unfortunate that the Government Property Council has not met since January 1990 because of changes made during the turnover of Administrations. [Ref. 20]

Another attempt to correct accounting deficiencies was made when the DOD recently revised its property administration manual entitled: The Department of Defense Manual for the Performance of Contract Property Administration. This manual prescribes procedures and techniques to:

(a) meet management data requirements and (b) assure performance of property management to protect the interests of the Government at minimum cost through a uniform DOD contracting property administration program. [Ref. 22:p. 1]

In the past, this manual has been included in the Defense Federal Acquisition Regulation Supplement (DFARS). However, according to Ms. Johnson, the revised manual will be included in a separate, stand alone manual and will no longer be included in the DFARS. [Ref. 20]

2. Initiatives to Decrease the Property Provided

As the Deputy Secretary of Defense in 1981, Mr. Frank Carlucci articulated a set of management principles designed to increase the integrity of Defense acquisition. These "Carlucci Initiatives," as they were later referred to, included plans for contractors to increase their capital investments and subsequently decrease the amount of GFP utilized.

In November 1985, the Navy, in response to these Carlucci Initiatives, implemented a policy which required contractors to provide their own ST and STE (including IPE and OPE) for production contracts. As a result of the controversy over this policy, the Congress passed Public Law 99-500 in the 1987 Defense Appropriations Bill which stated that contractors may be reimbursed for up to 50 percent of costs incurred when producing ST or STE. The remainder would be amortized over the life of the contract. The policy became effective on January 16, 1987.

The law was changed again by Section 810 of Public Law 100-180 which was included in the National Defense Authorization Act for fiscal years 1988 and 1989. This law is implemented into the procurement regulations under DFARS 215.873 and states that at least 50 percent of the total amount negotiated for ST and STE for a production contract will be reimbursed on that contract. The purpose of PL 100-180 is to shift part of the burden of financing these costs to contractors, but not in a way to cause undue financial risk.

3. Initiatives to Improve Inventory Control Systems

On December 10, 1987, the Deputy Assistant Secretary of Defense for Procurement, Ms. Eleanor Spector, issued a list of 10 essential elements of an adequate inventory system. Ms. Spector referred to these systems as "Material Management Accounting Systems" (MMAS). [Ref. 23:p. 5]

The final rules for MMAS were published in Defense Acquisition Circular Number 88-7 dated May 31, 1989. The DFARS describes MMAS in paragraph 242.7202 as:

A contractor's system(s) for planning, controlling, and accounting for the acquisition, use, and disposition of material. MMASs may be manual or automated and they may be integrated with planning, engineering, estimating, purchasing, inventory, and/or accounting systems, etc., or they may be essentially stand-alone systems. [Ref. 24]

This control system applies to: (1) Contractor Acquired Property (FAR 45.101); (2) progress payments material inventory (FAR 52.232-16 (d)(2)); and (3) contractor material charged to the contract. The MMAS does not apply to GFP per FAR 45.101. [Ref. 23]

The requirements for a contractor to have a MMAS, as found in DFARS 242.7204, are imposed upon:

All contractors who receive prime contracts, other than contracts awarded under the set-aside procedures of FAR Part 19, greater than the small purchase threshold set forth in FAR 13.000 and which are either (1) cost reimbursement contracts, or (2) fixed price contracts with progress payments. [Ref. 24: para 242.7204]

It is interesting to note that, although FAR 45.104 requires the Administrative Contracting Officer (ACO) to approve a contractor's property control system, DFARS

242.7205 requires the ACO to neither approve or disapprove a contractor's MMAS, but only determine whether it adequately conforms to the standards set forth in DFARS 242.7206. The two methods are separate, equal methods of controlling material. The 10 elements of the MMAS are included in Appendix (B).

One method of reducing inventory carrying costs is through implementation of a "Just in Time" (JIT) production planning system. This system has been used for the last 20 years in Japan to reduce costs and improve quality in the manufacturing process and is being implemented in many American firms today. According to Dobler, Burt, and Lee, the operating policy of an effective JIT application is to:

Minimize production and work-in-process inventories by providing each work center with just the quantity of materials and components needed to do a given job at the exact time they are needed. [Ref. 17:p. 433]

The continued application of JIT systems throughout the United States should decrease inventory carrying costs of all contractor inventories - including Government Furnished Material. This will result in less indirect cost allocation to Government contracts due to inventory carrying costs.

E. SUMMARY

This chapter has explored the current problems faced by DOD in accounting for the property furnished to its contractors and focused on several initiatives to improve control. The purpose of this chapter was to provide the reader the framework within which to ascertain whether DOD accurately accounts for the commercial use of GFP in its contractors' facilities.

The following chapter discusses the Defense Department's policy regarding contractor use of GFP for commercial work.

III. THE POLICY REGARDING CONTRACTOR USE OF GOVERNMENT FURNISHED PROPERTY FOR COMMERCIAL WORK

The purpose of this chapter is to examine the DOD's policy regarding the commercial use of GFP and in neutralizing Defense contractors' competitive advantage from utilizing GFP.

A. THE POLICY REGARDING COMMERCIAL USE OF GOVERNMENT FURNISHED PROPERTY

Defense contractors are normally required to furnish whatever property is necessary to perform Government contracts. In some circumstances, however, it is advantageous for the Government to provide property to its contractors. Once the contractor receives GFP for use on a Government contract, the PCO must require the contractor to be responsible and accountable for the GFP in the contractor's possession and to keep the official Government records for the GFP unless other provisions have been prescribed by the PCO. Additionally, the PCO must: (1) ensure that the property is used to the maximum extent possible in performing the Government contract; (2) provide written authorization before allowing the contractor to utilize the GFP for commercial purposes; and (3) charge appropriate rent when the contractor is authorized to use the GFP for commercial purposes on other than a rent-free basis. [Ref. 25]

It is DOD policy that all regulations pertaining to a contractor utilizing GFP for a Government contract also pertain to foreign military sales contracts. However, the contractor must obtain the PCO's specific written authorization to use GFP on foreign

contracts and appropriate rental payments will be collected by the Government for that use unless specific approval for rent-free use is granted. [Ref. 24: para. 245.401]

Rental receipts received by the PCO or ACO are deposited in the U.S. Treasury. These offsetting receipts are deducted from budget authority and outlays.

1. Accounting for the Commercial Use of Real Property

The FAR defines real property to include land, rights in land, ground improvements, utility distribution systems, buildings, and other structures. Any of these items may be provided to a Government contractor for use on a Government contract. Real property with an acquisition cost in excess of \$100,000 is normally provided through a facilities contract to the Government contractor. Real property with an acquisition cost less than \$100,000 will normally be provided under the protection of an appropriate Government property clause or an appropriate facilities clause. [Ref 25: para. 45.302-3]

The facilities contract or the appropriate clause in any other contract will specify the specific terms of the use and rent of the real property when authorized for commercial use. In either case, the contractor is responsible for determining the non-Government usage of the real property and for computing the rent to be paid to the Government for each rental period. The contractor is required to submit a written statement on the use of the property, the calculation of the rents to be paid for that period, and the payment for the rent due to the PCO (or the ACO if authorized) within 90 days after the close of each rental period. [Ref. 25: para. 52.245-9(f)]

The Use and Charges clause, located in Appendix C, requires the use of sound commercial practice for computing rental charges for non-Government use of Government

real property. The full rental value of real property is calculated as if 100% of the real property is in a rent-pay status. This clause provides for a credit to be deducted from the full rental value for the amount of rent-free usage. The rent-free usage credit is based on a unit of measure (direct labor hours, sales, or hours of use) that will result in an equitable division of the rental charge between rent-pay and rent-free usage. The rent-free use is then divided by the total use and the quotient is multiplied by the full rental value to determine the rent-free usage credit. This rent-free usage credit is then subtracted from the full rental value to calculate the total rent due. [Ref. 25: para. 52.245-9(e)]

2. Accounting for the Commercial Use of Plant Equipment

The FAR defines plant equipment as personal property of a capital nature for use in manufacturing supplies or performing services, or for any administrative or general plant purpose. Plant equipment includes equipment, machine tools, test equipment, furniture, vehicles, and accessory and auxiliary items, but does not include ST or STE. [Ref. 25: para. 45.101]

The contractor determines the non-Government usage of plant equipment and computes the rent due for each rental period. As with real property, within 90 days after the end of each rental period, the contractor must submit a written statement on the use of the property and the rent due to the PCO (or ACO) as well as the payment itself. [Ref. 25: para. 52.245-9(f)]

The specific rent for plant equipment is calculated using the rates delineated in Table I of the Use and Charges clause. The monthly rents specified in the FAR are

applied to the acquisition cost of the equipment according to the Federal Supply Class and age of the equipment.

According to the provisions of DFARS 245.407, all non-Government use of IPE exceeding 25% requires prior approval of the Assistant Secretary of the Army (RD&A), Assistant Secretary of the Navy (RD&A), Assistant Secretary of the Air Force (Acquisition), or the Director of the Defense Logistics Agency, unless specifically delegated to the Head of a Contracting Activity. The percentage of this non-Government use is calculated on the basis of time available for use of the IPE. [Ref. 24: para. 245.407(a)]

3. Accounting For the Commercial Use of Special Tooling and Special Test Equipment

The FAR does not provide specific instructions for calculating the rental payments for ST or STE due to the nature of this property. However, FAR 45.403 explains that rent for classes of property other than that which is included in the Use and Charges clause may be charged on the basis of use rather than rental period or on some other equitable basis.

The DOD Directive 2140.2 applies to the recovery of fair share of DOD cost for ST and STE. According to DFARS 245.403, the rental rates for ST and STE are established for each contract separately through negotiations between the PCO and the contractor under the provisions of DOD Directive 2140.2. [Ref. 24: para. 245.403]

B. NEUTRALIZING COMPETITIVE ADVANTAGE

Neither the FAR nor the DFARS address the competitive advantage a Defense contractor may gain on the commercial market by utilizing GFP for commercial purposes. All policy guidance for PCOs to utilize when evaluating offerors for a Government contract is located in FAR Subpart 45.2.

1. The General Policy

The general policy provides that PCOs should either: (1) adjust the offers of bidders by applying a rental equivalent evaluation factor on those offerors already possessing GFP; or (2) charge the contractor rent for using the property. The rental equivalent factor should be equal to the rental charge that would have otherwise been charged to the property [Ref. 25: para. 45.201]. The FAR provision at Subpart 45.201 states that it is not appropriate to apply a rental equivalent factor in awarding negotiated contracts when the PCO determines that using the factor would not affect the choice of contractors. Furthermore, when evaluating offers, the PCO should:

consider any costs or savings to the Government related to providing such property, regardless of any competitive advantage that may result. [Ref. 45: para. 45.201(b)]

2. Additional Factors to Consider

Additional factors must be considered in evaluating bids and proposals if furnishing GFP will result in direct, measurable costs that the Government must pay, or savings that will accrue to the Government. These factors will be specified in the solicitation and are limited to: (1) reactivation from storage; (2) rehabilitation and

conversion; and (3) making the property available on a "free on board" (f.o.b.) basis.

[Ref. 25: para. 45.202-3(a)]

If the contractor agrees to pay the transportation costs or the rehabilitation and conversion costs, then no additional factors related to those costs will be utilized. Also, if using GFP will result in significant savings to the Government, the amount of these savings will be included in the solicitation and used in evaluating offers. [Ref. 25: para. 45.203-3(b)-(c)]

3. Residual Value of Special Tooling and Special Test Equipment

When the PCO is awarding competitively negotiated contracts which permit the acquisition of ST or STE, the PCO should make an evaluation of the residual value of the property to the Government if: (1) the PCO determines that the GFP will have a possible use and a residual value after contract termination; and (2) the PCO anticipates the cost of the GFP may be a factor when making the award. The PCO should not make this evaluation if the acquisition of the ST or STE is provided for under the contract as a contract line item. [Ref. 25: para. 45.204(a)]

By evaluating this residual value of the property, the PCO apportions only that part of the total cost of the GFP to the amount consumed during the contract performance. Accordingly, the proposed price or cost is reduced for evaluation purposes by that amount. When estimating the residual value of ST and STE, the PCO should consider: (1) the useful life of the GFP to be acquired; (2) adaptability of the property for use by other contractors or by the Government; (3) foreseeable requirements for future use of the property; and (4) the scrap or salvage value of the property. [Ref. 25: para. 45.204(b)]

4. Solicitation Requirements

When GFP is offered for use in a competitive acquisition, the solicitations should require the contractor to assume all costs related to making the property available for use. The solicitation should also describe the evaluation procedures to be followed. These evaluation procedures will include rent charges or equivalents and other costs or savings which will be evaluated. [Ref. 25: para. 45.205(a)-(b)]

The solicitation should also require all offerors to provide the following information: (1) a list or description of all GFP that the offeror or its subcontractors propose to use on a rent-free basis; (2) identification of the contractual instrument under which the property in the possession of the offeror or its subcontractors is held, as well as the written authorization for its use by the PCO or ACO having cognizance for the property; (3) the dates during which the property will be available for use; and the amount of rent that would otherwise be charged. [Ref. 25: para. 45.205(b)(1-4)]

C. SUMMARY

This chapter has examined the DOD policies in regard to Defense contractors utilizing GFP for commercial purposes and has explored the Government's policies for neutralizing a contractor's competitive advantage when submitting competitive solicitations. It was ascertained that there is no current policy statement to neutralize a Defense contractor's competitive advantage in the commercial market when that contractor utilizes GFP for commercial purposes.

The following chapter reviews audit reports of Defense contractors utilizing GFP for commercial work.

IV. AUDITS OF CONTRACTORS UTILIZING GOVERNMENT FURNISHED PROPERTY FOR COMMERCIAL WORK

This chapter summarizes a representative sampling of reports by the U.S. General Accounting Office (GAO), Department of Defense Inspector General (DOD-IG), Army Audit Agency, Naval Audit Service, and the Air Force Audit Agency.

The purpose of this chapter is twofold: (1) to identify the problems encountered by Government auditors in the commercial use of GFP; and (2) to identify the potential misuse of excessive quantities of GFP and inadequate recordkeeping in Defense contractors' facilities.

A. REPORTS BY THE U.S. GENERAL ACCOUNTING OFFICE

The initial GAO report on DOD's accounting for GFP was issued in 1967. Although the GAO has never reported specifically on DOD's accounting for contractor use of GFP for commercial work, the agency has questioned DOD's accountability for excessive property in contractors' facilities. Four of the ten reports on DOD's management of GFP issued by the GAO illustrate problems which refer to this potential misuse of GFP for commercial work.

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

In an earlier report, GAO advised the Secretary of Defense that inadequate administration of GFP had resulted in: (1) unnecessary investment in inventory; (2)

increased transportation costs; (3) possible unnecessary procurement; and (4) potential shortages of GFM at some locations. One of the causes of these deficiencies was the inadequate surveillance of contractors' performance by Government property administrators.

This follow-up audit disclosed several additional weaknesses in the accounting for GFM. Two of these weaknesses included: (1) Air Force contractors ordering material directly from the Government supply systems and receiving shipments of this GFM with negligible Air Force surveillance; and (2) the inability of the auditors to compare contractors' use of GFM because the Air Force's requirements lists were incomplete or inadequate.

"Challenges to Reducing Government Equipment in Contractor Plants," (LCD 77-417, September 1977).

The auditors concluded that control over contractor use of GFE should be strengthened. The DOD must be more aggressive in obtaining contractor compliance with the regulations. In essence, the DOD does not have full visibility over what its GFE is being used for.

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

The auditors determined that the DOD does not maintain adequate accounting for GFM provided to production contracts. Because of this, millions of dollars of GFM were provided to contractors in excess of their contractual authorizations and in excess of the amount required to fulfill the Government contract. The auditors' bottom line: the DOD does not have control over what its GFM is being used for.

"Controls Over Material Furnished to Navy Contractors Can Be Improved,"
(NSIAD-88-150, June 1988).

It was discovered that, in some cases, contractors were authorized to requisition GFM without the Navy making a best interest determination, and commercial sources could have provided the materials, possibly at a lower cost.

The auditors concluded that the Navy has made little progress in implementing DOD policies for adequately controlling GFM provided to contractors. They determined that oversight of contractors' property control systems is inadequate. These weaknesses could result in the failure of contractors to report GFM valued in the millions of dollars as potential excess material and therefore, increase the potential for fraud, waste, and abuse.

Since 1985, GAO and Naval Audit Service reviews have identified over \$286 million of GFM as being potentially in excess of needs. After GAO identified over \$8.5 million in excess GFM under one contract, the contractor reviewed his GFM inventory and identified \$5.8 million as excess and cancelled \$4.3 million of additional material requisitions from the Navy supply system.

B. REPORTS BY THE DOD INSPECTOR GENERAL

As a result of the numerous unfavorable Congressional Hearings, the DOD-IG has recently begun investigating the administration of contractor rental of DOD Plant Equipment. The purpose of these audits is to determine whether ACOs adequately

administer contractors' rental of DOD plant equipment and to evaluate the effectiveness of related internal controls.

A summarization of an earlier audit on control of GFM is presented followed by three of the recent audits on administration of contractor rental of GFE.

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

The auditors determined that excess material valued at \$24.8 million was found at 14 of the 15 production contractors reviewed. This excess resulted from DOD activities shipping more material than required ("pushed" material) and from contractors ordering more material than required ("pulled" material). The DOD had not previously accounted for this excess material.

"Contractor Rental of Government Real Property and Payment of Nonrecurring Costs," (89-087, June 1989).

The Defense Department provided \$4.1 billion of Government real property to contractors on 131 Government production contracts in 1987. The DOD's contractors paid \$12.6 million of rent in 1987 on 38 separate contracts for the non-Government use of the real property.

It was concluded in this audit that the DOD failed to collect over \$8.9 million on real property rent on the 38 contracts reviewed.

The auditors determined that internal controls for the establishment of rental rates need improvement. Real property rentals for Defense contractors' use of DOD real property were not based on sound commercial practice and subsequently, not all rent was paid. Additionally, rental payments for contractors' use of Government real property for

Independent Research and Development (IR&D) efforts were improperly offset against the Government's share of the contractors' IR&D costs on two separate contracts.

"Administration of Rental of DOD Plant Equipment at Boeing Helicopters," (90-013, December 1989).

In 1988 Boeing paid the Government \$66,793 in rent for non-Government use of DOD owned plant equipment. The auditors discovered that Boeing miscalculated its non-Government use of GFE associated with sales to Korea as rent-free when calculating rental payments for 1988. This resulted in an underpayment to the Government of \$6,866.

"Administration of Rental of DOD Plant Equipment at SACO Defense Incorporated," (90-065, May 1990).

This audit focused on rent payments totaling \$153,294 during fiscal year 1988. The auditors determined that interest payments on \$113,586 due from the contractor for late rent payments were improperly offset against contractor costs to rehabilitate GFE.

C. REPORTS BY THE ARMY AUDIT AGENCY

The Army Audit Agency has conducted many audits which demonstrate the potential for unauthorized commercial use of GFP. Two of these audits are summarized below.

"Government-Furnished Property, Detroit Tank Plant, Warren, Michigan," (EC 83-603, March 1983).

The auditors concluded that management of GFP at this facility is inadequate. The Government cannot account for the contractor's use of GFP. Four findings were noted: (1) the contractor does not have adequate procedures in place to identify and report excess

GFM; (2) sufficient documentation is not always available to support the contractor's request to acquire GFE; (3) inventory losses for GFE are written off accountable records without adequate research; and (4) financial records are inadequate and can not be used as internal controls or to make the GFE provided to the contractor visible to Government managers.

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

This audit also concluded that the management of GFP is inadequate. The contractors which were audited do not adequately account for GFP ordered and utilized and inventory losses occur frequently. As both general and subsidiary ledger accounts for GFP are not being maintained, in essence, the Army does not know how its GFP is being used.

D. REPORTS BY THE NAVAL AUDIT SERVICE

Two audits by the Naval Audit Service are summarized below.

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

This Defense contractor maintains over \$303 million of GFP including \$36 million of GFM, and operates with outdated and incomplete inventory control procedures. As the GFP is not adequately controlled, the Navy does not know how its GFP is being used.

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

The auditors determined that this contractor retained approximately \$114.5 million of GFM from previously completed contracts and held an additional \$7.1 million in GFM

even though there had been no demand for the material for over twelve months.

They concluded that Government property administration is insufficiently performed to evaluate the contractor's property control system which controls \$3.4 billion of GFP. The auditors' bottom line is that the Navy does not know how its GFP is being used.

E. REPORTS BY THE AIR FORCE AUDIT AGENCY

Two reports by the Air Force Audit Agency are summarized below.

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

The auditors determined that GFM held by the contractor is in excess of DOD contractual requirements. They discovered that property accountability records which display locator and identification data are not accurate. The auditors further determined that GFE is being used on several contracts without proper approval or authority.

"Contractor Use of Government Furnished Equipment for Commercial Use," (9066411, October 1989).

In 1988 the Air Force collected over \$5.4 million in rent payments for the commercial use of GFE. This audit disclosed that procedures to identify and collect rents due the Government are inadequate. As a result, the Air Force Plant Representative Offices allowed contractors over \$1.6 million in rent credits that were not authorized.

The auditors recommended that procedures be established to: (1) identify and track the commercial use of GFE; (2) require that contractors submit all requests for GFE use for commercial purposes to the ACO; (3) discontinue providing blanket authorizations for

commercial use of GFE; and (4) develop a suspense system for tracking rents due and validating the accuracy of rent payments.

F. SUMMARY

This chapter has reviewed reports by the GAO, the DOD-IG, the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency. The following summarizes the reports by these agencies:

- a. Contractors are being provided GFP: (1) in excess of contractual requirements; (2) without the DOD having full visibility over its GFP; (3) without contractors having adequate procedures to report excessive quantities of GFP; and (4) even though financial records are sometimes so inadequate that they cannot be used by the Government to manage the GFP provided to its contractors.
- b. Excessive quantities of material is: (1) being ordered by contractors from the DOD supply systems without Government surveillance; (2) being "pushed" by the DOD to its contractors; and (3) being held at the contractors' facilities rather than being placed back into the supply systems where shortages sometimes exist.
- c. Oversight of contractors' property control systems is: (1) sometimes inadequate; and (2) sometimes so incomplete that it prevents DOD managers from controlling how the GFP is actually being used.
- d. The Defense Department: (1) is not aggressively ensuring compliance with the regulations regarding GFE use; (2) sometimes fails to require sufficient documentation from the contractor to support his request to acquire GFE; (3) sometimes allows inventory losses of GFE in the contractors' facilities to be written off without adequate research; and (4) sometimes allows GFE to be used on several contracts without proper approval or authority.
- e. Internal controls for establishing rental rates for commercial use of GFP need to be strengthened; non-Government use of GFP for foreign commercial sales work requires collection of rental payments by DOD; and interest on late rental payments have been improperly offset against contractor costs to rehabilitate GFE.

- f. Procedures should be established to: (1) identify and track the commercial use of GFE; (2) require that contractors submit all requests for GFE use for commercial purposes to the ACO; (3) discontinue providing blanket authorizations for commercial use of GFE; and (4) develop a suspense system for tracking rents due and validating the accuracy of rent payments.

The conclusions of these Government auditors will be addressed in the next chapter as the interviews with both DOD Property Administrators and contractor Property Administrators are presented.

V. SURVEY RESULTS

A. INTRODUCTION

The data presented in this study were gathered through a random survey of 30 Government Property Administrators (GPAs) from 30 separate Defense Plant Representative Offices (DPROs) throughout the country and 20 of their contractors' Property Administrators (CPAs). Each survey was conducted by telephone and lasted approximately 45 minutes. All Government interviewees were at the GS-11/12/13 level and the average property administration experience for the contractor interviewees was in excess of 20 years.

As many of the questions asked of the interviewees could reveal significant discrepancies in their own organizations, the respondents were encouraged to answer freely on a nonattribution basis. The aggregate listing of all respondents is presented in Appendix D.

The survey was designed to determine if experienced property managers in the field believed that Government accountability for the commercial use of GFP is adequate or whether the system should be improved and how it should be improved. Central to the study is the assumption that these managers are best able to determine the adequacy of the current system. This assumption is based upon the DOD established policy of uniform property management procedures across all Services.

The survey consisted of 16 questions and the interviewees were encouraged to elaborate on any response. This survey was not intended to be a statistically significant sampling of responses, but rather a collection of opinions from the experts in the field of property administration.

B. THE RESPONSES

1. Question One

What are the biggest problems in DOD's accounting for the commercial use of GFP?

a. Government Responses

The biggest problem identified by the GPAs was trusting the contractor to accurately report the time that the GFP is actually used for commercial purposes. Fifty-three percent of those surveyed listed this as the largest accountability problem. Thirty-seven percent agreed that because the contractor keeps his own utilization records, the Government is at a disadvantage when accounting for the commercial use of GFP.

Others were concerned that the Government was not collecting the proper rents because the GFP had not been identified as belonging to the Government by the contractors' floor supervisors who are ultimately responsible for recording non-Government use. Some typical comments received are paraphrased below:

We simply have to trust the contractor. I have a feeling they are not always accurately reporting the commercial use. DCAA performs audits, but I have the responsibility of surveillance. The only saving grace is that the Government's OPE and IPE is so old, that most contractors cannot use it anyway!

We need to find a uniform way to automate all DOD contractors' property records. The current method that they use today is updated only once per year. There is no standard method - each contractor does it differently. Contractors need a real time system to keep track of all receipts and shipments of GFP and the PAs should be able to monitor this system.

The rental rates that the Government charges are far below what they should be. These rates were negotiated years ago and have not been updated. The rental rates should be based upon the commercial value of the property.

Contracts are not written with the support people in mind. The PCO is not providing a list of GFP to be used on the contract to the PA. The PCOs do not understand what is involved in accounting for GFP. The PCO should list the GFP to be used in the contract and subsequent modifications should add or subtract from this list.

The PCOs are allowing the contractor to use GFP for commercial purposes without understanding the procedures. The ACO should be making those decisions based upon the PAs' recommendations.

A big problem is accounting for durable - consumable material. The contractors charge the Government for durable - consumable GFM after only one use when, after testing, it could be used again and again. How do I know if the contractor is using this expended GFM for commercial contracts?

Conflicting directives make the PA's job even tougher in accounting for commercial use. For example, the Commercial Space Launch Act tells us to do just the opposite of what the Use and Charges Clause in facilities contracts tells us to do.

Special tooling is the hardest to account for. For example, If two similar work-in-process items are running down the production line together, and if one item is for a Government contract and the other is for a commercial contract, how is that worker on the production line going to know to record the time the commercial item spent on the Government's ST used as part of the manufacture process?

The PA does not have the time to monitor what the contractor is using GFP for. Sometimes the PAs can only be at a contractor's facility for only a few hours during the entire calendar year.

The most popular solution offered by the GPAs was for DOD to utilize blanket authorizations for all Government and commercial use of GFP and to charge the contractors a flat rate rental agreement on a not-to-interfere basis.

b. Contractor Responses

Twenty-five percent of the 20 CPAs surveyed stated that they were not aware of any problems the Government had with accounting for the commercial use of GFP. These contractor representatives stated that they simply used the formulas in the FAR for calculating the appropriate rents due.

Additional comments received were:

The Government is still living in the Dark Ages. Some of the words and terms in FAR Part 45 come from the old ASPR from the 1950s. The FAR needs to be revamped to the 20th century. The system is too cumbersome and too detailed.

We may build 20 units at one site. When we build them, we don't know if they are going to the Government or to a commercial contract. Keeping track of the usage of GFP in these situations is not always feasible.

ST and STE is the toughest property to account for. There is no reliable way to record the usage. If we have two jigs, side by side, and one was provided by the Government, how are we suppose to accurately account for its use on commercial contract work?

The PCO needs to define in the contract the GFP that will be supplied for use on that contract. Too often the buying agencies do not specify what they will provide so the GPAs do not know what we have.

DOD does not really know what is in the contractors' facilities. Because there are no checks and balances by the GPAs, the Government is operationally blind as to what the contractors are using GFP for.

2. Question Two

Are the regulations regarding the commercial use of GFP being properly enforced? How can the regulations and the enforcement mechanisms be improved?

a. Government Responses

Always:	10%
Most of the time:	53%
Some of the time:	20%
Never:	0%
Undecided:	17%

A clear majority of the respondents believed that the regulations are being properly enforced most of the time. Due to the nature of the question, however, 17% felt uncomfortable discussing the inadequacies of their surveillance. The most popular response indicated some confusion between DOD's policy of contractor self-governance and their requirements to enforce the regulations. Presented below are some paraphrased comments in response to this question:

Improving oversight takes additional time and it is not a high priority when allocating time. I do not have the manpower to improve enforcement. We used to have three PAs, now we only have one doing the same job. I only have time to work the big problems, not improve procedures.

I am solely responsible for 44 contractors. Each utilization survey takes one week. That's at least 43 weeks that I cannot visit the other 43 contractors. How do I know what they are using the GFP for during that time?

It is a systemic problem. The ACO should withhold progress payments if the contractor has been caught using GFP for commercial work without permission. A deficiency on the utilization survey should be written up and forwarded to the ACO for action. The PAs are not getting support from the PCOs or the ACOs.

We just recently caught a contractor using GFP without authorization from the PCO. The situation involved three production workers using two machines. One of those machines was GFP, the other was owned by the contractor. One of the workers used the GFP on a commercial job while we were doing floor checks. If we had not been standing directly over him, we never would have caught him.

There is very good control under facilities contracts which are greater than \$5,000 because utilization records are required in these contracts. The Government needs to phase out all Government owned facilities. The Government pays the cost of repair of those facilities through overhead, even when the contractor is using the facilities for commercial work.

The contractor should be required to label all production items with a metal tag - not a paper tag that he can tear off. The metal tag should list the contract number so the PAs could more easily track what is commercial work and what is Government work.

The regulations are too ambiguous, they need to be more specific. Every agency uses a different policy. There is no uniformity. The DOD Directive 4145.2 is a good start. It is much easier to read and understand than the old Supplement 3 to the DFARS.

The regulations are good enough, but they need to be enforced. The PAs need more assistance from the engineers and production people. The PAs have to rely on the Government Quality Assurance (QA) Representatives. The QA folks are trained to look for unauthorized use.

We need to increase the statistical sampling audits. We had a problem where the contractor was using STE for commercial work without authorization. The DCMAO discovered the problem and increased the sample size. Now it has been corrected at that facility.

The CPAs should be required to go to the same schools that the GPAs attend. They do not always know the Government requirements. We need better communications between GPAs and CPAs and this would be a good place to start.

We have a special program in place at this contractor's facility that is working extremely well. The plan was approved at the negotiating table between the PCO and the contractor's corporate staff and the contractor has applied it across the board to all divisions. The plan requires the contractor to pay the Government two percent of all commercial sales across the board

for the use of the Government's facilities, regardless of the amount of time the facilities were actually used. The plan is easy to administer and easy to audit. Both DOD IG and the Naval Audit Service have approved the plan.

The regulations are clear, but they take a lot of circumstances into account. Sometimes, commercial use cannot be separated out. The regulations should be guidelines, not stringent requirements. The PAs need the latitude to establish guidelines on what to audit.

The PCO should address commercial use of GFP in the contract or in subsequent modifications. The PCO is not involved enough. The PCO should require contractors to identify the GFP required in the RFP. If identified up front, the GFP would have better visibility by the PAs in the field. As it stands now, I enforce the regulations only after I stumble across the property in the contractor's facility. The PCOs simply do not have enough training in this area - they do not know the ramifications of their actions.

The Government's Production, Engineers, Quality Assurance, and Property Administrators (PAs) need more training on accounting for commercial use of GFP. The problem involves funding. I cannot afford to send my interns to school.

b. Contractor Responses

Always:	30%
Most of the time:	35%
Some of the time:	30%
Never:	0%
Undecided:	5%

The contractor responses were evenly distributed among the three categories and only one CPA felt uncomfortable discussing the question. It is interesting to note that 63% of the GPAs believed the regulations were being enforced at least most of the time and 65% of the CPAs believed the regulations were being enforced at least most of the time. Typical responses are paraphrased below:

The Government should not be in the property business in the first place. The Government should require contractors to provide their own material and equipment to build their own product. Tools are the biggest problem to account for. The ST in our facility would not work to build anything else, so why should the Government own them? There is no way to accurately measure the usage of ST and STE.

The Government should establish a new program and negotiate with the contractor the amortization and eventual ownership of the GFP that the contractor requires.

The regulations are sufficient. A good DPRO will check on the contractor often, even though contractors are inherently honest. The real problem involves the turning over of GPAs. That's when we have the communication problems.

Considering the large amounts of GFP that we have at our facility, there is no better way to account for its use. A monthly survey would be totally impossible.

The Government needs to make the procedures more simple. We need aggregate numbers and gross percentages. If we followed the details of the regulations, we would spend more money in administration than the Government would recoup in additional rental receipts.

The Government needs to depreciate its GFP. Rents should be based upon fair market value, not original purchase price.

The manpower cutbacks on both sides have hindered proper accountability. Property control is a necessary evil and the Government is hard pressed to cover all the bases. The easy regulations are the ones being enforced, not the difficult ones.

The commercial use of the GFP should be agreed upon up front, at the negotiating table and put in the contract. We have a common job, we should work together.

3. Question Three

How accurately are Defense contractors accounting for GFP on the DD FORM 1662 ("Report of DOD Property in the Custody of Contractors") per DFARS 245.505-14? How can this reporting system be improved?

a. Government Responses

Very accurately:	37%
Somewhat accurately:	53%
Not accurately:	0%
Undecided:	10%

The primary reason why 53% of the GPAs believed that the accuracy of the reporting was not very accurate involved problems with subcontractor reporting of the GFP in their facilities. The GPAs felt that the subcontractors' PAs are not reporting accurately to the prime CPAs. Additional comments are paraphrased below:

GFM should be reported throughout the entire production process. Senator Glenn is currently looking at changing the requirement for reporting work-in-process inventory. We have in excess of \$1 billion of GFP at my contractor's facility and an additional \$400 million in work-in-process that is not currently being reported.

The additions and deletions columns are irrelevant as they are being used by the Government. All the Government needs is beginning inventory plus additions less transfers equals ending inventory.

Contractors with manual systems need to automate and account for GFP on a real time basis. This is the only way to accurately report receipt and transfer of GFP. This would increase control throughout the year, not just account for the GFP once every year. We do not use slide rules anymore.

When the depots provide the property, they need to completely fill in the DD 1348 shipping document. A complete description of the property would give the contractor what he needs to establish complete and accurate records which, in turn, would improve the accuracy of the DD FORM 1662.

Financial data for land, plant, and equipment is reported at original acquisition price, not at current market value. Especially the land is worth so much more than is actually being reported. This obscures the real value of what the Government owns. For example, what if the Government still owned Manhattan Island... How much did the Government pay the Indians for it? That amount would still be reported on the DD FORM 1662.

The DD FORM 1662 is up to the GPAs to enforce, but it is a yearly struggle. It depends solely upon the accuracy of the contractor's record keeping system. I really feel the contractors are trying hard to comply. It is a learning process. The reporting has improved each year.

What does the Government want? The DD FORM 1662 is only a readout for 1/365 of the time. Contractors only update once per year, yet receipts and transfers of GFP occur almost daily. When October comes, the money available to PCOs increases, so the contract awards also increase. The DD FORM 1662 is reported in September and does not reflect this increase in GFP. It should be reported on a quarterly or monthly basis to be more accurate. Currently, the system is too vague, it leaves too much for interpretation. It is only a best guess estimate.

The biggest mistakes occur on small dollar value, high volume items. The contractors need an automated system and be able to pass the information along to the Government on a floppy diskette on a regular basis. This would make the reporting more accurate, and decrease the overall administration time presently required.

We have a new system called CPMS which stands for "Contract Property Management System." This is the second year we've had it and it works very well. The contractor puts his accountability records on a tape and forwards to the Government. It is very accurate.

Accounting for property does not make money for the contractor. It is a low priority for the contractor, that is why they are not always accurately reporting the GFP in their facilities.

b. Contractor Responses

Very accurately:	50%
Somewhat accurately:	45%
Not accurately:	0%
Undecided:	5%

The contractors' representatives were decidedly against the reporting of work-in-process inventory on the DD FORM 1662. Most of the CPAs stated that it would not be cost beneficial to report to that degree of accuracy and that it would be totally impossible to report in a cost-plus contracting situation. Additional comments are paraphrased below:

The DD FORM 1662 is a good tool for both the Government and the contractors. It works well for both sides. The Government should not try to improve the reporting process unless it is willing to pay more for the information.

Large contractors are very accurately reporting the GFP in their facilities. However, the smaller contractors and the subcontractors are not reporting accurately at all. Greater discipline is required at the subcontractor level. If they do not tell the prime contractor how much GFP they have, the GFP does not get reported.

We report to the very best of our ability. It is a very difficult and tedious process. I have been reporting for four years and I am yet to get any Government feedback on how I am reporting. It increases the administration costs without any benefits coming back to the contractor. We have between 100 and 150 Government contracts ongoing at any given time. This information gathering takes too much time.

Why does the Government require the detail on the DD FORM 1662 that it requires? The addition and deletion columns on the form are irrelevant.

I'd hate to take the DD FORM 1662s to the bank and try to cash them in! The property at subcontractors' facilities is either not counted, or is counted twice. There is no way to verify the accuracy of the DD FORM 1662.

A real time automated system is required to effectively and correctly report what the Government requires.

4. Question Four

Does DOD have full visibility over contractors' use of GFP?

a. Government Responses

Very good visibility: 3%
Good visibility: 57%
Little visibility: 33%
Undecided: 7%

The GPAs believed that for the most part, the Government does have good visibility over contractors' use of GFP. However, 33% disagreed that the Government had good visibility. Typical responses are paraphrased below:

If you do not ask the right questions, you will not get the right answers. The Government does not really know what to do with the information it gets from the contractors.

The visibility of the GFP depends upon the visibility of the contract. Big contracts have lots of visibility and the property does also. Also, new programs have lots of visibility, but once a program is in progress, the visibility of the GFP wanes.

We do not have good visibility over the GFP at the subcontractors' facilities. Property sent to the subcontractor by the prime contractor is not looked at by the GPA unless the prime CPA asks the Government to get involved.

Not all PCOs know what they need to know about GFP. The contractor can talk the PCO to sign up to whatever they want because the PCOs do not interface with the GPAs. Bad communications among all Government agencies hinder visibility.

We cannot watch the contractor 100% of the time. We only know what he is doing one day out of the year, and the contractor can even change things that day as well!

The contractors are not reporting 100%. There is stuff in the corners that the Government has no idea is out there. Visibility is improving, it is much better than it was five years ago. The contractor has to keep much better records today.

We try, but we cannot be everywhere at once. I do not think contractor self governance will help our visibility problems. Statistical sampling picks up trends, it does not improve visibility.

ST is the worst to keep track of. GFM is probably the next worst. Every PA looks at the system differently. The different interpretations by the PAs of the regulations do not help DOD's visibility.

The PAs need to be in the contractors' facilities, not snowed under by paperwork at their desks. I cannot spend enough time in the plant because I have to do my own typing and filing. I am working on Saturdays just to keep up on my typing and filing. We have to trust the contractor too much.

b. Contractor Responses

Very good visibility:	30%
Good visibility:	35%
Little visibility:	35%
Undecided:	0%

Thirty percent of the CPAs believed that the Government has very good visibility over contractors' use of GFP. Only three percent of the GPAs believed that the Government had very good visibility. Responses of the CPAs are paraphrased below:

The contractor can use GFP for whatever he wants. The Government has to trust the contractor. They do not know what we are really using it for.

DOD only sees the wording in the contract. They do not have a lot of hands on experience. Once a GPA is fully trained, he quits working for the Government and begins working for a contractor. The Government agencies do not communicate well between themselves.

SPAWAR recently sent us an inventory listing of what it thought we had for GFP inventory. We had transferred most of the equipment over 15 years ago! No, I do not think DOD really knows what we have and what we do with it.

DOD is restricted by the number of personnel they have. Since DOD reorganized, they do not have as many people watching us as they used to. I think they have lost some visibility during that reorganization.

The Government does not have good visibility over GFM, especially if a strict interpretation is taken over the use of progress payments inventory as GFM.

We have well trained GPAs looking over our shoulders. The Government checks us once per year, that's enough oversight. Visibility depends solely upon the capability of the GPAs.

5. Question Five

What additional procedures should be established to identify and account for the commercial use of GFP?

a. Government Responses

With few exceptions, the Government respondents indicated that the existing regulations were adequate but they just needed to be enforced better. Presented below are comments received regarding recommendations for additional procedures:

The GPAs need to "trust, but verify." We need more PAs in the plants to verify how the contractor is actually using its GFP.

The contractors should have to report to the PAs whenever they utilize GFP for commercial purposes. Instead, they often bypass us and report to the PCO.

It's too hard to look over the contractor's shoulder to verify that he is accurately reporting commercial usage. Why not negotiate blanket agreements based solely upon a percentage of commercial sales?

We should require the contractors to list out the uses of the GFP in addition to the number of hours they used it for. There is currently no requirement for the contractor to report: "this quarter we will use GFP for x hours for y commercial projects."

The right of the contractor to use the GFP for commercial purposes should be addressed at the negotiating table. The property and the commercial usage should be explicitly described in the contract.

The PCOs need better training. When the contractor asks the PCO to use GFP for commercial purposes, the PCO usually does not answer in a timely fashion. We get the impression that they just do not want to be bothered.

Perhaps a bar coding system would help the contractor account for the usage on-line. An on-line computer system is the best way to track usage of all GFP as well as receipts and transfers.

GFM should not be allowed to be used on commercial contracts at all. It is too hard to account for. The contractor should be forced to purchase his own material for his commercial contracts.

b. Contractor Responses

The CPAs basically believed that the current procedures were adequate.

Some of the comments received are paraphrased below:

The contractor needs to audit himself. We need to find a happy median to work in between Government requirements and contractor administration.

No more procedures! Our records we are required to maintain are adequate. A lot is ambiguous and unnecessary, but we keep them anyway. The Government needs to make the system more reasonable to deal with. There are too many cases where the Government has put accounting controls over management systems, over administration, over everything!

The more procedures that the Government imposes on the contractors, the less cost effective the process becomes. DOD should redefine the procedures already in place and get current accounting practices. We need teamwork between the contractor and the Government.

There is always a way for the contractor to rig the system. DOD has to trust the contractor. The contractors have to audit themselves.

The Government should be aware of the commercial applications the contractor could use its GFP for and focus its efforts in that direction.

The contractor should not simply be allowed to use GFP for commercial purposes.

6. Question Six

How can procedures be strengthened to ensure GFP that is either excess to a Defense contractor's requirements or is no longer required on a contract is removed from the contractor's facility?

a. Government Responses

This question provoked a myriad of responses. The popular opinion was that the disposition of excess GFP takes too long and the GPAs feel that they do not get the support from the buying offices that they should be getting. Typical comments received are paraphrased below:

Plant clearance takes too long. The PA should work directly with the Program Manager and the PCO/ACO to dispose of excess property. We need to shorten the screening cycle. I have seen property being screened for two years.

If the contractor does not use GFP in a certain time period, the DOD should charge him a rental fee. Many contractors keep excess property as an insurance policy.

The DOD does not close out its contracts quickly enough. The PA should work with the contractor to help him dispose of the excess property. Forced dispositions are necessary during contract close-outs because it is too easy to move GFP from one Government contract to another.

Program managers should take a more aggressive role in disposing of the excess property. There is a need for upper management awareness on both sides.

The contractor is no longer authorized "no cost storage agreements." This forces the contractor to get rid of property, but PCOs want them to hold on to the property "just in case" they ever need it.

Timely contract close-outs is the first step. Some contracts have not been closed out for 12 years! Also, the PCO should give the ACO the authorization to take care of disposal of excess property.

The Navy never wants to get rid of tooling. The procedures are adequate, but the buying offices never want to dispose of anything once they have it in the contractor's facility.

The contractors sometime bypass the GPAs and send requests to retain property directly to the PCOs. The PCOs are not aware of procedures and give them authorization to swap items between contracts. The PAs usually do not know what is going on.

We need a system where, before final completion of the contract, the contractor checks to see if residual property can be transferred. The procedures should begin before final delivery under the contract.

We need more GPAs in the plants, yet self governance is the goal. I'm confused.

There are too many screening requirements to report the excesses. Item managers often cannot identify the GFP because the contractors are using their internally generated part number - even for items that have NSNs. There should be greater control to ensure the contractors use the proper identification numbers when they send these screens out.

The PCO and the Program Manager must make the disposition decisions and tell the PAs what to do with the property in a timely fashion and provide the transportation money to ship it with. PCOs and ACOs need to be more aggressive during contract close-out.

Nothing triggers the contractor to say "this is excess." The trigger is usually the last delivery. Utilization studies are not really performed.

b. Contractor Responses

Nineteen of the 20 CPAs interviewed also believe that the current procedures for disposing of excess GFP need improvement. Some of the comments received are paraphrased below:

There are too many interpretations of the regulations. We need one disposition regulation instead of the 40 or more that we currently have for GFP.

We need to overhaul and streamline the entire disposition process. The Plant Clearance Officers should be able to negotiate the sale of excess GFP to the contractors.

There are too many duplicate shipments of GFP in the first place. We have excess GFP hanging from the rafters! We need better coordination between the DOD agencies supplying the GFP.

The day we ship excess property out is the day we will need it somewhere else in the plant. R & D people are always reluctant to give up excess property.

We need more items to come under the automatic disposition procedures. We have Government lathes under that program and it works great. Under this procedure the contractor does not have to screen excess property.

We need to establish a choke point on the PCO. I ran an excess listing and waited almost five years before the DOD told me where to ship it. The Government is its own worst enemy. The contractors try to dispose of the excess property in the proper way, but the Government slows the process.

The Plant Clearance Officer needs to have the authority to make judgement decisions. We ship too much junk back and forth for the Government. It is not worth the money spent.

The buying agency is negligent every time. I have excess GFP that I have been trying to get disposition instructions on for almost three years.

Disposing of GFP at the subcontractor level takes forever. We work directly with the PCOs. It takes too long to work with the Plant Clearance Officers.

We report to the Air Logistics Command at Warner Robbins whenever we have excess property. They always sit on the request for several years before we receive disposition instructions. Why does it take that long?

The Government needs to be more stringent on contract close-out procedures. It is not a high priority.

7. Question Seven

How can oversight of Defense contractors' property control systems be improved to control the use of GFP?

a. Government Responses

The most popular response was the need for more GPAs to be in the contractors' facilities and for the GPAs to receive more training money to send their interns to property management schools. Additional comments are paraphrased below:

We need production, engineering, and QA specialists to work with the PAs under a team concept. With the manpower reductions taking place throughout DOD, we need to work together even more.

Now that self governance is the focus, we need better CPA training. Monitoring the contractor is less a priority today than it use to be. Today, the annual survey is the backbone of the PA's job. This is wrong; I need to be in the plant doing my job.

I can only cover the high risk areas because of the manpower reductions. My PA branch shrunk from five PAs to two PAs and we have the same responsibilities. I have to rely upon the contractors because I am at my desk all day long. We need on-sight representation at the plants.

Property is a dead-end profession. We top off at the GS-12 level. There is only one GS-13 on the West Coast. If we want to advance, we either switch to become Contract Specialists or we leave the Government altogether and go to work for the contractors.

The new requirement of self governance: once a contractor receives a satisfactory annual survey, the Government does not have to survey again for another two years (DLA letter of 23 November 1990, Serial 90-3, para 2(a)). This will not help oversight.

Utilization studies should be performed by the Industrial Specialists. They currently are not being performed. There is no training money to send my interns to property management schools. DCAA needs experienced PAs with the proper training.

b. Contractor Responses

The full spectrum of responses was received: some CPAs felt that there were too many GPAs looking over their shoulders, however most of the respondents believed that the GPAs were understaffed and needed additional manpower. This spectrum is illustrated by the eight responses paraphrased below:

We have oversight from everybody right now! We are audited 10 times per year on every item of GFP that we have in our facility. Please, no more oversight!

A realistic review of requirements for performance is required. Justification by the contractor for GFP receiving marginal use should be mandated by the Government.

I know the Government cannot track every piece of equipment in the system, but it appears that they are certainly trying to do just that.

The Government needs to upgrade the quality of the GPAs. There should be a more rigid standard before a PA is allowed to audit a contractor. An upward mobility program is required.

There should be a separate category for ADPE on the utilization surveys. ADPE is not OPE, IPE, or ST and yet we have to classify it as one of those.

GPAs need to be upgraded to the status of Contract Administrators. Most GPAs are under educated and ill trained.

The GPAs are hard pressed to look at everything but once per year. They need more people in the plants. They do not have the personnel to ensure the job is done correctly.

There are too many different interpretations of the regulations. We need to have better educated DCAA auditors and the Government should enforce its contractor self governance policies.

8. Question Eight

How can controls be strengthened to establish proper rental rates and collection of these rents for the commercial use of GFP?

Although the subject of this question is not typically a PA responsibility, the researcher was interested in the PAs opinions in this area.

a. Government Responses

Only 10% of the respondents believed that the existing controls as mandated by the FAR were adequate. Other responses are paraphrased below:

It is up to the ACO to collect the rents. It is up to the PA to ensure they are reporting it correctly. The FAR is very precise in this regard.

The procedure for determining the rental rates is flawed. The Government should base the rents on the actual market value of the GFP, not on the acquisition cost of the assets.

The ACO is not collecting the rents properly. He waits until the rent is one year past due and then he directs the PA to administer the program and get the checks to him each period.

The ACOs and PCOs need additional training to understand what they are agreeing to during the negotiations with the contractors. Additionally, there should be a special provision in the contract to alert the contractor that he will be charged for any commercial use of the GFP. There are too many agreements by letter that should be formal modifications to the contract.

DCAA needs the expertise of a trained PA. Also, there should be facility-wide rental agreements with contractors to alleviate looking over the shoulders.

Collection of the rents is the biggest problem, especially with the high turnover of PCOs on the programs. The lack of consistent management leads to late rental payments.

The PCO should enter into a rental agreement with the contractor and the agreement should ensure that the consequences are spelled out for the contractor's failure to report commercial use of GFP. The contractor should pay full rent less any application towards the Government contract for all GFP in the facility.

b. Contractor Responses

Sixty-five percent of the contractor respondents believed that the controls should be improved in some way. Eight comments are paraphrased below:

The Government needs more people checking up on the contractors' utilization of the GFP, catch them using it without authorization, and enforce the requirements with a substantial penalty.

The current tables in use by the Government to calculate the rent are not adequate. The Government should charge rent based upon the market value of the item being produced and the market value of the GFP being used to produce it. A one year old lathe has the same value to the contractor as a five year old lathe. As a matter of fact, it is to the contractor's advantage to use the oldest GFP for commercial production since the Government will pay overhead to maintain and repair the GFP.

The rates should be negotiated by the PCO and the contractor's contracts people and the procedures should be clearly laid out in the contract.

The Government needs a more restrictive regulation and a better method for calculating the rent. Every few years we go through the turnover of personnel at the ACO and DCAA levels and we have to re-invent the wheel on how to calculate the rent. It is always a judgement call on the part of the local Government agency.

The Government needs to utilize bar coding as a means of recording the time the GFP is used on a certain commercial job. The bar code machine would print out a record of daily usage.

If the Government gives the contractor the authorization to use GFP for commercial production, then there should be a separate contract for that usage. Fair rental rates should be established in the contract. A generalized rate is not a good basis.

The Government and its contractors need to work together. Through better education of the GPAs we can work together to establish methods of capturing the data the Government requires.

The rental rates should be comparable with industry rental rates. The Government should charge the same as industry charges to rent the same equipment. The rates should be based on fair market value.

9. Question Nine

How effective is DOD's policy in accounting for its contractors' use of GFP for commercial purposes? What modifications should be made to the policy or to the enforcement of the policy?

a. Government Responses

Very effective:	20%
Somewhat effective:	43%
Somewhat ineffective:	20%
Not effective:	3%
Undecided:	14%

Twenty percent of the respondents believed that the Government's policy in accounting for the contractors' commercial use of its GFP is very effective. However, 23% of the respondents felt that the policy was either somewhat not effective or not effective. Typical comments are paraphrased below:

The snapshot is good for only one day of the year. That is the only time the Government really knows what the contractor is doing with the GFP.

There should be a quarterly survey of the contractor's usage if the commercial use is greater than 50% of Government use of the GFP.

By definition, ST and STE can only be used for a specific purpose. If a contractor is using ST or STE for commercial purposes, it really is not ST or STE by definition.

This is such a grey area. The Government will never be able to always be there whenever a contractor uses GFP for other than the intended contract. Also, the Government never has good visibility over its subcontractors.

The PAs should have the authority to work with the contractor's middle management - not just the line supervisors. Contractor Deficiency Reports just do not get the attention that letters written to middle management receive. The middle managers will get the problems fixed.

The penalties for noncompliance are not stiff enough. If the contractor is late with a payment, a stiff penalty should be imposed - that will get his attention. Today, he just has to pay the full amount due the Government.

The ACO should have control. The PCO should not shorten the pipeline. PCOs should authorize ACOs to handle all contractual responsibilities for contractors utilizing GFP for commercial purposes.

It has to be a team effort between the Government's buying offices and the ACOs, PAs, and Production Specialists. The Government has to get its act together before we can expect the contractors to do the same, especially in contract close-out.

The Bill of Materials must be defined in the contract. All terms and conditions for the commercial use of GFP must be defined up front.

b. Contractor Responses

Very effective:	30%
Somewhat effective:	50%
Somewhat ineffective:	0%
Not effective:	5%
Undecided:	15%

Thirty percent of the contractor respondents believed that the Government's policy in accounting for the contractors' commercial use of GFP was very effective. This is compared with 20% of the GPAs' responses. Typical responses are paraphrased below:

"Bean counters" do not add to the contractor's profit, so accounting for GFP takes a low priority with the contractors. If both the GPAs and the CPAs had the manpower they needed, there would not be any accountability problems, but I do not think we will ever be fully staffed. Perhaps we need more automation.

The contractor needs to have an internal audit system to ensure that he is doing what the procedures tell him to do. The contractor can correct the accountability problems if he finds them himself.

There should be a separate contract for the commercial use of any GFP. It should not be tagged onto any other Government contract.

We need one regulation. The Government needs to incorporate all GFP regulations into one. Most policies are good, but each DOD agency has its own interpretation of the DOD policies.

The policies need to be streamlined. If the existing policies were enforced to the letter, the Government would need at least three PAs at each DPRO to enforce these policies.

The policy is only as effective as the contractor wants it to be effective. If the Government relies on the honesty of the contractor, then the policy is not effective at all. A system that relies solely upon honesty with an occasional check is not adequate.

The utilization surveys should be done by PAs who are technically qualified. The skill level of the GPAs is not sufficient.

The Government should upgrade the quality of its PAs. The good PAs are not properly rewarded to stay in Government service. I worked for the Government for 22 years. The contractor offered me more pay and benefits, so I left Government service. As soon as the GPAs are trained and are qualified, they change sides.

The Government's collection of rents should be based upon end item cost rather than formulas.

10. Question Ten

How effective is DOD's policy in neutralizing its contractors' competitive advantage from using GFP on commercial work? How should this policy be changed?

a. Government Responses

Very effective:	10%
Somewhat effective:	43%
Somewhat ineffective:	7%
Not effective:	10%
Undecided:	30%

Fifty-three percent of the respondents believed that the Government's policy was at least somewhat effective although 30% of the respondents were uncomfortable with the question and preferred not to answer. This is probably because the topic area is somewhat removed from the PAs' normal functions. Typical responses are paraphrased below:

The Government should either get out of the property business altogether, or increase its surveillance.

PCOs are responsible for neutralizing competitive advantage. They need additional training in this area. They seem to take the contractor's word too often without checking.

Any GFP that can also be used by another company to produce the same product should not be GFP. The contractor should not be allowed to obtain the GFP if it can also be used for commercial purposes.

The PCOs do not look at the big picture. They only see one contract that they are negotiating at that time. They are not taking competitive advantage into account.

The contractor knows that his minimum business is the Government contracts that he has been awarded. It is not unusual for the contractor to charge all of his start up costs to the Government contracts and then not redistribute these other costs to his commercial contracts.

If he is using GFP for commercial work, then it is definitely giving him a competitive advantage.

The buying commands do not know what GFP is out there. They do not check. They do not ask the PAs. Of course there is competitive advantage!

b. Contractor Responses

Very effective:	25%
Somewhat effective:	20%
Somewhat ineffective:	5%
Not effective:	0%
Undecided:	50%

A significant 50% of the contractor respondents preferred not to answer this question. Of the ones who did respond, 45% believed that the policy is somewhat effective or very effective. Typical responses are paraphrased below:

The policy is very effective. There is no competitive advantage if everybody follows the rules. But, are they following the rules?

It is not to our advantage to use GFP for commercial purposes because the rental rates are too high in most cases.

The contractor simply cannot use GFP without authorization. It is a very effective policy.

There is not very much competitive advantage from using GFP on commercial work.

With any Government contract we lose some competitive edge anyway. It all evens out in the long run.

If there is competitive advantage, it is gained in the design phase.

11. Question Eleven

Is DOD getting its "fair share" of rent payments (and interest from late rent payments) from contractors utilizing GFE for commercial purposes? Please explain your response.

a. Government Responses

Always:	0%
Most of the time:	33%
Some of the time:	37%
Never:	0%
Undecided:	30%

Most of the respondents preferred to preface their response with "based on my own experience." It is interesting to note that none of the respondents believed that the Government is always getting its fair share of rent payments from contractors utilizing GFE on commercial work. Responses are paraphrased below:

The fair market value is greater than the original acquisition cost, so the rent should be based either upon what the end product should cost or the value of the equipment if the contractor had to rent it in the commercial market.

Lots of contracts are negotiated by the PCO without the PCO knowing what he really is giving to the contractor.

We need "bird dogs" out in the plant. We cannot expect the contractor to always be honest, even though they are scared to death of being caught.

I have seen situations where the ACO did not even expect to receive the rent check from the contractor and did not even know what to do with the money when he received it. If the ACO is not enforcing the controls, why should the contractor send the rent money?

People on the production floor are not aware if the equipment is GFE or contractor owned. It is just another forklift to them. If they need to move a pallet, they use the next available forklift. I do not think we are getting rent payments for those situations.

Very seldom do I discover any unauthorized use of GFE. I believe we always receive fair share of rent payments from IPE because I receive a quarterly utilization survey from the contractor on IPE use.

b. Contractor Responses

Always:	35%
Most of the time:	20%
Some of the time:	5%
Never:	0%
Undecided:	40%

More of the contractor representatives felt uncomfortable discussing this question than the GPAs. However, 35% of the CPAs believed that the Government always received its fair share of rent from contractors utilizing GFE for commercial purposes. Only three of the 20 CPAs interviewed felt comfortable offering an explanation for their answer. These responses are paraphrased below:

The contractor has to follow the Government's rules. It is just that simple.

We need a more defined system for gathering cost data. There are too many cost centers in the contractors' facility to determine whether the Government is receiving its fair share.

The rents that the Government charges the contractor should be based upon current market value, not on the original acquisition cost.

12. Question Twelve

Are you aware of any contract where a "blanket authorization" for the contractor to use GFE for commercial purposes was granted by the PCO or the ACO? If yes, then please explain the circumstances and the effects on Government accountability for the rents received.

a. Government Responses

Yes, I know of an example: 7%
No, I do not know of an example: 93%

Only two of the 30 GPAs had heard of an occasion when a blanket authorization for the contractor to use GFE for commercial purposes had been granted.

Their responses are paraphrased below:

In this case, when the program was first tooled up, the contractor paid a percentage for the ST and STE that he would use for commercial purposes. The Government owns all the ST and STE in the facility. Today, the agreement is that the contractor will use all the ST and STE under a blanket authorization and the contractor does not pay any rent whatsoever. It is working very well because we do not have to track the contractor's actual use, but the Government is not receiving any rent payments either.

The contract really started in the 1950s during the Korean conflict. Under a facilities contract that we had in place during the period 1984 - 1987, the contractor was able to use the facilities for whatever commercial purposes under a blanket authorization granted by the PCO.

b. Contractor Responses

Yes, I know of an example: 15%
No, I do not know of an example: 85%

Three of the 20 CPAs knew of an example of a blanket authorization being granted by the PCO. Two of the three respondents gave examples under foreign military sales contracts and the third respondent's example is presented below:

The situation involved ADPE. We proposed to the PCO that if he granted us use of this equipment and sufficient overhead for commercial production, that whatever the GFE was used for, the costs would be applied equally among the Government and the commercial programs. The PCO granted the blanket authorization. I think it worked out very well for the Government. They did not have to track our actual usage on the GFE to charge us rents.

13. Question Thirteen

Are Material Management Accounting Systems (MMAS) effective in controlling the unauthorized use of contractor acquired property, progress payments material inventory, and contractor furnished material on commercial contracts? Please discuss your response.

a. Government Responses

Very effective:	10%
Somewhat effective:	10%
Somewhat ineffective:	10%
Not effective:	0%
No experience with MMAS:	70%

Seventy percent of the respondents had no experience with MMAS and did not feel qualified to offer a response. The remaining 30% were equally divided among the top three responses. Responses are paraphrased below:

My contractor is still working to get it approved. It is too new of a program to fairly comment on it yet. However, I believe that both the PCO and the ACO need training to understand MMAS.

I cannot answer because I do not have any first hand knowledge. The PAs are not involved with MMAS. It is not a team effort. The ACOs are bypassing the PAs on this program. I think that is a big mistake.

My answer is based only on the one approved system that my contractor has. I think it depends upon how the system is written up. Once the system is approved, I believe it protects the Government's interests.

DCAA and contracts people have taken over the MMAS and I am not involved. The PA should have some input on the MMAS, but we have nothing to do with the system.

The regulation is good. It clarifies a lot of the grey areas. I just wish they had listed my responsibilities in the MMAS. I do not believe I have much to do with this system, but I am not sure.

I think that it is a good system. My contractor is now fully approved.

I think it is a slap in the face of the GPAs. The ACO and DCAA are running this program and we have nothing to do with it.

Based only on what I have read about MMAS, I believe it will be very effective. I do not think we have the system at my contractor's facility, but I am not sure. The CPA has already received training on MMAS, but the GPAs have not.

b. Contractor Responses

Very effective:	50%
Somewhat effective:	20%
Somewhat ineffective:	0%
Not effective:	0%
No experience with MMAS:	30%

The contractor representatives interviewed who had worked with MMAS seemed very positive about the system. Fifty percent believed the system was very effective and another 20% believed the system was somewhat effective. Only 30% of the contractor representatives had no experience with MMAS compared to 70% of the GPAs. Responses are paraphrased below:

It will be very difficult to demonstrate the true effectiveness of MMAS. The effectiveness will be incorporated into how the contractor builds the system.

I think the program is moving too slowly! It is a very good system for controlling inventory transfers.

The only problem that I am aware of is in the situation where my company is working on an R&D contract and we need to use material that came in under a Government production contract. If it is a long lead item, then when we pay back the Government, the item will cost the production contract more than it would have if we had not taken the item in the first place.

14. Question Fourteen

How effective is the implementation of Material Control Activities (MCAs) in reducing Defense contractors' unauthorized access to the DOD supply systems?

a. Government Responses

Very effective:	7%
Somewhat effective:	3%
Somewhat ineffective:	0%
Not effective:	0%
Not familiar with MCAs:	90%

Only three of the 30 Government interviewees were familiar with MCAs. Twenty-seven of the GPAs were not familiar with the program and asked the interviewer to explain the system to them. The three respondents who were familiar with the program believed that the system will improve the contractors' unauthorized access to the DOD supply systems.

b. Contractor Responses

Very effective:	0%
Somewhat effective:	0%
Somewhat ineffective:	0%
Not effective:	0%
Not familiar with MCAs:	100%

None of the 20 CPAs were familiar with MCAs.

15. Question Fifteen

Is DOD getting its "fair share" of reimbursement from contractors utilizing GFM for commercial purposes? Please explain.

a. Government Responses

Always:	13%
Most of the time:	20%
Some of the time:	10%
Never:	0%
Undecided:	57%

Fifty-seven percent of the GPAs did not feel sufficiently experienced to answer this question. Of the remaining 43%, the clear majority believed that the Government was getting its fair share of reimbursement from contractors. The responses are paraphrased below:

I make sure that the contractor pays for anything he takes from our stack. That's my job.

I have a monthly meeting with the contractor and the Government's production people to review our borrow/loan transactions for the previous month. I personally check the list of transfers that the contractor provides me each month to ensure the Government is getting its fair share.

The first time we heard of any transfers was when the contractor recently proposed a modification to the contract to pay for the transfers. We are just getting up to speed on this procedure.

I cannot verify if the Government is getting the full amount it is due. The Government should get acquisition cost.

Every Government part that is borrowed by the contractor is personally approved by the ACO. This is working well for us at this facility.

b. Contractor Responses

Always:	60%
Most of the time:	15%
Some of the time:	0%
Never:	0%
Undecided:	25%

All 15 of the contractor representatives who felt comfortable responding to this question believed that the Government was receiving its fair share of reimbursement. The typical response by these PAs was that the Government gets what it is entitled to get.

16. Question Sixteen

How can procedures be improved to ensure that GFM which is no longer required on the Government contract is placed back into the DOD supply systems where shortages sometimes exist?

a. Government Responses

Typical responses indicated that there is much frustration on the part of the GPAs regarding this situation. Presented below are paraphrased comments made by the GPAs:

Why the Government cannot use nuts, bolts, rings, and adapters somewhere in its operations I will never understand. I just hate throwing these parts away.

Communication and visibility are the key words to improving this situation. The Government needs to understand what is available for them to use.

The contractors must be forced through terms in the contract to turn all excess material over to the Government within a specific time frame.

The buying activities own the material. We need better screening procedures to redirect the GFM to another Government activity. To improve the screening process, we need to: (1) force the contractor to alert buying activities of all excess material; (2) improve communications between buying activities; and (3) improve coordination between DOD agencies.

The contractor bypasses the PA and screens directly to the PCO. The PCO eventually sends a letter directly to the contractor telling him to hold the material for further disposition instructions. The PAs and the Plant Clearance Officers are no longer involved.

We need to ensure the PA can get out in the plant to identify excesses. The contractor needs training in Government disposal procedures. The CPAs should be required to attend the three week PA school at Wright Patterson Air Force Base.

Its a matter of how well we monitor the contract close-out procedures. The contractors' and the Government's engineers need to get involved. They know what is really excess.

The PCOs are not taking material already on hand at the contractors' facilities into account when they negotiate the contracts. They just keep offering up the GFM and the contractors' contracts people accept it. The DCAA and the PCO should check with Plant Clearance and the PAs before negotiating the contract.

The problem is that most buying activities are not familiar with plant clearance procedures.

There should be more visibility of what is available. I do not believe the inventory control points (ICPs) are seriously reviewing the inventory schedules.

We need automated screening that will identify a part on the plant clearance schedules. There are not enough eyes in the system to look at the schedule. They only look at it when they need a particular part.

Getting the supply activities to take back a part is the biggest bottleneck. Congress looks at the dollars spent, not the urgency of need for the part. So, we continue to dispose of material regardless of demand in the system because it is just not cost effective to return it to the system.

There should be specific disposition instructions in the contract. The contractor is not always reporting the excess material to the ACO usually because he does not perform a complete inventory at contract completion.

The contractor should cross his own part numbers to NSNs and FSCMs so the supply systems can better identify what he is claiming to be excess.

b. Contractor Responses

The CPAs also had many varied opinions on how to improve the current reutilization of excess GFM. Typical comments are paraphrased below:

I just received notification back from a Government Program Manager to scrap two parts we classify as GFM costing \$119,000 and \$140,000 because it would cost too much to put them back into the supply system. That must be some administrative cost that the Government charges!

We need a better screening system world-wide; a better way to screen excess material out to the troops and the ships that may need this excess material. We only average a three percent reutilization rate, the rest is scrapped.

When the contractor reports residual material, I do not believe the right Government people are seeing the list.

The cognizant Government activity must act in a timely fashion. They must be notified of the contract completion to ensure proper disposition of material.

The contractor needs up front direction in the contract as far as the disposition of excess material is concerned. Something in the line of: "at contract termination the residual GFM will be sent to X activity within Y time frame."

The contractor should work closely with the Government Plant Clearance Officers. The contractor should not work directly with the PCO on plant clearance matters.

There needs to be greater heat placed on the PCO. The contractor tries to dispose of the excess GFM properly, but we keep waiting for instructions. The longer we have to wait, the more the GFM becomes contractor owned. It costs the Government additional overhead expenses for us to store excess GFM.

The current procedures are specific. If everybody follows the rules, everything will work out alright, but, the Government must learn to follow their own rules. Let's enforce the time schedules already in place.

It is a good system. Most of the excess GFM is not placed back into the supply systems, most is disposed of.

We need stricter enforcement of contract close-out procedures. The current procedures are good, but contract close-out is not perceived as being important.

The Government should require a cyclical review by the contractor to identify all excess material.

Let's look at the value of this GFM. Some GFM should not be GFM because contractors can buy it as cheaply as the Government can. So, why does the Government insist upon providing it in the first place? Nails, screws, and washers are the biggest problems. Why does the Government furnish these items?

C. DISCUSSION OF THE DATA

All of the PAs were very willing to discuss deficiencies in the Government's accounting for the commercial use of GFP and to offer possible solutions to the problems. The researcher sensed an eagerness on the part of these professionals to share their opinions in hopes that their concerns might be communicated to higher levels.

The specific concerns and possible solutions offered by these respondents are summarized below.

1. Effectiveness of the Government's Policy

Only 20% of the GPAs and 30% of the CPAs responded that they believed the Government's policy was very effective in accounting for the contractors' use of GFP for commercial purposes. Twenty-three percent of the Government respondents and five percent of the contractor respondents believed the policy was somewhat not effective or not effective at all.

Several respondents questioned the use of ST and STE by a contractor for commercial production. They reiterated the definition of ST and STE as being for a specific purpose only. They believed the FAR should be modified to prohibit the use of ST and STE on commercial work.

Other PAs sought tougher penalties for noncompliance with the policy. Still others cited the requirement for GPAs to have the authorization to work with the contractors' middle management. Another respondent stated that the policy would be better enforced if the ACO was solely responsible for managing the commercial use of GFP.

Other recommendations to improve the Government's policy include additional contract provisions, additional training, automation of the contractors' records, improving contract close-out procedures, improving visibility of GFP in small contractor and in subcontractor facilities, increasing manpower, and correcting specific accounting problems.

2. Contract Provisions

A clear majority of the respondents indicated that many accountability and communication problems could be rectified if these issues were addressed during contract negotiations and specifically delineated in the contract. Both Government and contractor personnel believed that specific provisions in the contract should include: (1) a complete list of the GFP to be utilized in the performance of the contract; (2) any restrictions or provisions for the commercial use of GFP; (3) time frames for reporting and turning over excess material; and (4) provisions for the disposition of residual GFM.

3. Additional Training

The respondents discussed the necessity for additional training for both contractor and Government personnel. Some PAs stated that PCOs and ACOs need additional training: (1) in the management of GFP - specifically in accounting for the commercial use of GFP; (2) in neutralizing a contractor's competitive advantage when utilizing GFP; (3) in the MMAS; and (4) in property disposal procedures. Others believed that CPAs should attend the same property management schools as GPAs in order to facilitate better communications between the Government and the contractor and to better understand the Government's requirements, especially in regard to property disposal.

Some CPAs stated that the DCAA auditors should work with experienced and well trained GPAs to better understand property administration. Additionally, most respondents believed that GPAs, CPAs, production, engineering, and QA personnel needed additional training in accounting for the commercial use of GFP.

4. Automation of Contractors' Records

Most of the Government respondents and several of the contractor respondents stated that the DOD contractors' property administration records should be automated, utilizing a uniform, real-time data processing system to account for Government Property receipts and transfers. It was further hypothesized that the GPAs should have the capability to monitor this system. The purpose of this automated system would be twofold: (1) to facilitate the annual submission of the DD FORM 1662; and (2) to

account for commercial use of GFP in the contractors' facilities. Automated screening procedures to identify GFP on plant clearance schedules was also recommended.

Prior to installing any automated property accounting system, many CPAs expressed the need for cost-benefit analysis to be performed to ensure these systems would be cost effective and not just another layer of Government mandates.

5. Contract Close-out Procedures

Several respondents suggested improvements in the current contract close-out procedures. They stated that contract close-out is not perceived as being very important in the scheme of Government contracting and suggested that contract close-out procedures should take a higher priority in both procuring and in administration activities than they have in the past. They recommended: (1) contract provisions incorporating forced dispositions for GFP to prevent property which is used on one contract from being transferred to another contract at the same contractor's facility; (2) the ACO having the sole authorization to dispose of excess GFP; and (3) greater involvement by both contractor and Government engineers in identifying residual GFP before contract completion. One CPA recommended that more GFP be included in the automatic disposition procedures for excess property.

6. Visibility in Small Contractor and Subcontractor Facilities

Many interviewees believed that DOD lost much of its visibility over its GFP in small contractor and subcontractor facilities. They complained that these smaller firms were not reporting accurately on the DD FORM 1662 and that it takes an excessive

amount of time to dispose of excess property that is located at the subcontractor level. They reiterated that property sent to subcontractors by prime contractors was not surveyed by the GPA unless the prime's CPA specifically requested the Government to get involved.

7. Effects of Manpower Reduction

The subject of limited personnel was discussed in almost every interview. Most GPAs complained of being understaffed and overworked. They stated that they really only had the time to work the big problems and they could only hope the small ones would take care of themselves. They protested that they did not have the time to get into the contractors' facilities more often because their office work kept them at their desks. Furthermore, they requested greater assistance from the production, engineering, and QA personnel who were able to work in the contractors' facilities. Some also argued that the high turnover of both PCOs and ACOs caused a lack of consistency in managing Defense programs and sometimes resulted in late rental payments.

Several CPAs agreed that the GPAs have lost some visibility over the utilization of GFP because of the manpower shortages throughout DOD. One CPA stated that only the "easy" regulations were being enforced for this reason. Some CPAs complained of the high turnover of the GPAs and the resultant communication problems these turnovers present for the contractors.

8. Specific Accounting Problems

Several PAs requested the Government make the accounting procedures more reasonable to deal with and incorporate current accounting procedures throughout property administration. They requested: (1) simple, straightforward disposition regulations; (2) the elimination of conflicting directives when accounting for the commercial use of GFP; and (3) the need for the contractor to have an internal audit system to identify accounting mistakes early. Others identified problems when accounting for durable-consumable GFM, the commercial use of ST and STE, and the progress payments material inventory. Still, others questioned the usefulness of the additions and deletions columns on the DD FORM 1662.

One contractor respondent questioned the accounting for the utilization of GFP on commercial work when his company produces 20 units ahead of schedule without knowing how many would be ultimately sold to the Government. Another questioned how the rent calculations could be different each time the ACO left and a new ACO interpreted the regulations. A third CPA suggested that Government agencies should use the same accounting procedures for GFP throughout DOD in order to enhance uniformity.

Several Government interviewees suggested that the Supply Depots should completely describe the GFP that is shipped to the contractor on the DD FORM 1348 in order for the contractor to establish a more complete and accurate record upon receipt. They also suggested the requirement for the contractor to report: "we will use GFP for x hours for y commercial projects this quarter." Another suggested the requirement for

a quarterly survey of contractor usage if commercial use exceeds 50% of Government use for any quarter. Currently, there is no reporting requirement to this effect.

Other PAs suggested that the rental rates the Government charges for the commercial use of GFP should be compatible with commercial rates and should be based upon the market value of the GFP and not upon the acquisition price. A few suggested that the Government depreciate its GFP.

Many respondents believed that some control on the duplicate shipments of GFP to contractors' facilities would be required in order to improve accountability. One PA questioned why the Government provided small value items such as nails, screws, nuts, and bolts as GFM in the first place since these items could be purchased as reasonably by the contractor on the open commercial market.

The most popular accounting solution offered by the PAs was for DOD to negotiate authorizations for the Government and commercial use of GFP, to charge the contractors a flat rate percentage agreement on a not-to-interfere basis, and mandate that these provisions be incorporated into the contract.

D. SUMMARY

The results of interviews with 50 professional Property Administrators were presented in this chapter and numerous recommendations to improve the current accounting procedures for the commercial use of GFP were suggested.

The following chapter summarizes this study, draws conclusions, supports recommendations for improvement, and suggests areas for additional research.

VI. CONCLUSIONS, RECOMMENDATIONS, AND AREAS FOR ADDITIONAL RESEARCH

A. GENERAL

Chapter II discussed accountability problems and corrective initiatives underway to improve management controls in accounting for GFP in contractors' facilities. The Defense Management Review has identified several areas within the sphere of GFP for investigation and the Government Property Council has mandated the use of Material Control Activities on GFM requisitions throughout the DOD supply systems. Only three of the 50 Property Administrators interviewed were familiar with these MCAs.

This Council has also recommended a change the DFARS to require Defense contractors to account for all GFM in their facilities, even after it transitions to work-in-process inventory. Most of the Contractor Property Administrators interviewed do not believe this will be cost effective.

The Material Management Accounting System (MMAS) received favorable reviews from most of the Property Administrators interviewed, however the Government Property Administrators believed they should be more involved in the approval of the contractors' MMAS. The requirements for this new initiative are delineated in DFARS 242.7202.

An initiative to decrease the ST and STE provided to Defense contractors has recently been incorporated under DFARS 215.873. This newly revised regulation requires

that at least 50% of the total amount negotiated for ST and STE for a production contract will be reimbursed on that contract.

Chapter III examined the current policy regarding the commercial use of GFP. It was ascertained that there is no current policy statement to neutralize a Defense contractor's competitive advantage in the commercial market when the contractor utilizes GFP for commercial purposes.

Chapter IV identified the significant problems encountered by Government auditors when evaluating the commercial use of GFP. These audits exposed potential misuse of excessive quantities of GFP and inadequate recordkeeping in Defense contractors' facilities.

In Chapter V, questions regarding the current initiatives discussed in Chapter II, the current policy explained in Chapter III, and the conclusions of the auditors disclosed in Chapter IV were addressed to 50 professional Property Administrators from Government and industry.

B. CONCLUSIONS

The purpose of this study was to determine if DOD should strengthen its accounting for contractors' use of GFP on commercial work. The first conclusion of this study is:

- 1. The Department of Defense should strengthen its accounting for Defense contractors' use of GFP for commercial purposes.**

Current initiatives undertaken by the Defense Management Review and the Defense Property Council have not addressed the accounting for the commercial use of GFP.

Significant problems have been identified by Government auditors during agency audits and by the Property Administrators interviewed in this study.

Chapter III examined the current policy regarding the commercial use of GFP and the first subsidiary question of this study questioned the effectiveness of this policy. The second conclusion of this study is:

2. **DOD's policy regarding the commercial use of GFP by Defense contractors is not very effective.**

Effectiveness of the policy is defined by the professionals who work with the policy every day. Only 24% of the Property Administrators interviewed believed the policy was very effective. One contractor Property Administrator remarked that the policy is only as effective as the contractor wants it to be effective.

The second subsidiary question for this study questioned the extent that using GFP *gives the contractor an unfair advantage in the commercial marketplace.* The third conclusion of this study is:

3. **There is currently no policy statement addressing competitive advantage in the commercial market when the contractor uses GFP for commercial purposes.**

Without procedures to neutralize the potential competitive advantage gained by using GFP on commercial products, contractors have little incentive to invest in their own facilities, tooling, or equipment.

The third subsidiary question for this research concerned the areas of contractor use of GFP for commercial work which have been identified by agency audits as needing improvement. As summarized in Chapter IV, agency audits recommended procedures be established to: (1) identify and track the commercial use of GFE; (2) require that

contractors submit all requests for GFE use for commercial purposes to the ACO; (3) discontinue providing blanket authorizations for commercial use of GFE; and (4) develop a suspense system for tracking rents due and validating the accuracy of rent payments.

The fourth subsidiary question considered whether DOD's accounting is sufficient to assure that contractors are providing adequate stewardship over the use of GFP for commercial work. The fourth conclusion for this study is:

4. **Current accounting procedures utilized by DOD are not sufficient to ensure that contractors are providing adequate stewardship over the use of GFP for commercial work.**

There are no uniformly applied accounting procedures. Each Defense contractor is solely responsible for accounting for, reporting, and paying rent on the commercial usage of GFP in their facilities.

In addition to the above conclusions, the following 15 deficiencies in DOD's accounting for its contractors' use of GFP for commercial work are identified:

1. **DOD relies solely upon the contractor to determine the actual commercial usage of GFP**
2. **PCOs are inconsistent in interpreting the regulations when charging rent for the commercial use of GFP**
3. **Poor communications between the Government agencies and between the buying offices and administration activities hamper adequate accounting**
4. **Insufficient training in the areas of property management of both contractor and Government personnel involved in the procurement process frustrates efforts to improve accounting**
5. **Cumbersome contract close-out procedures delay transfer of GFP to other contracts and facilitates the potential for the misuse of GFP on commercial work**

6. **Poor visibility of subcontractors' accounting for GFP and use of GFP for commercial purposes is prevalent throughout DOD**
7. **Significant Government Property Administrator manpower shortages limit DOD's visibility over its contractors' use of GFP**
8. **Conflicting directives and regulations hamper adequate accounting at the local level**
9. **Burdensome property disposition instructions prevent the efficient transfer of property to other programs and facilitate the potential misuse of GFP**
10. **Inconsistently applied accounting procedures hamper proper accounting**
11. **Duplicate shipments of GFP to contractors facilitate the potential for loss or misuse of GFP**
12. **Incomplete shipping documents from supply depots frustrate Property Administrators when accounting for the GFP in their custody**
13. **Antiquated rental rate calculation methods should be reviewed and updated**
14. **The Government unnecessarily provides commonly available items such as nails, ordinary screws, nuts, and bolts as GFM**

C. RECOMMENDATIONS

The fifth subsidiary question addressed the modifications which this study recommends should be made to the DOD's policy or to the enforcement mechanisms.

In regards to this question, the following 15 recommendations are presented:

1. **All GFP to be utilized on any Government contract should be fully identified in the contract or in subsequent modifications to the contract. All restrictions or provisions for the commercial use of GFP, time frames for reporting and turning over excess material, and provisions for the disposition of residual GFM should also be delineated in the contract.**

This easily accomplished recommendation would significantly improve many of the accountability and communications problems revealed in this study. Government and

industry contract administration personnel would understand the intent of the agreement between the Government's buying office and the contractor if they could rely solely upon the contract to facilitate communications.

2. **The Use and Charges clause located at FAR 52.245-9 should be amended to incorporate a flat rate charge based solely upon a percentage of commercial sales for any authorized use of GFP (excluding material) for commercial purposes. This charge would be consistently and uniformly applied to all applicable contracts.**

Most accountability problems occur because the contractor is tasked to account for the time each item of GFP is utilized for commercial purposes. Due to many factors outside their control, the Government Property Administrators often cannot accurately verify whether the contractor's reported usage reflects the actual usage.

This recommendation has already been incorporated into several contracts and based upon interviews with the applicable Property Administrators, has been approved by the DOD-IG and the Naval Audit Service. In these cases, the use of a flat rate charge has resulted in a greatly improved, simpler, and straightforward accounting for the commercial usage of GFP.

3. **Policies and procedures should be incorporated into the DFARS to neutralize a Defense contractor's competitive advantage in the commercial market when the contractor uses GFP for commercial purposes.**

There is currently no policy to alleviate whatever competitive advantage may be attained by using GFP for commercial purposes. By eliminating this competitive advantage, contractors would be further incentivized to invest in their own facilities, tooling, and test equipment.

4. **The DOD should refrain from providing commonly available materials such as nails, ordinary screws, nuts, and bolts as GFP.**

These items are readily available to Defense contractors through their normal supply vendors, and according to the contractor Property Administrators interviewed, usually at lower cost than the Government pays for them. The more GFP that is provided in a contract, the greater the risk to the Government of delays and loss of accountability for the usage of that GFP.

5. **Contractor Property Administrators should attend the same schools and training seminars as Government Property Administrators.**

This is required to facilitate better communications between industry and Government as well as to educate the Property Administrators "from the same book." This recommendation would also alleviate many conflicting GFP management techniques between Government and Industry Property Administrators.

6. **PCOs and ACOs should receive additional training in: (1) the management of GFP - specifically in accounting for the commercial use of GFP; (2) neutralizing a contractor's competitive advantage when utilizing GFP; (3) the MMAS; and (4) property disposal procedures.**

These are the areas highlighted by both contractor and Government Property Administrators during the interviews. Most commented that the PCOs and the ACOs usually do not understand property management. This often causes considerable confusion and misdirection of contract administration personnel.

7. **Uniform, automated accounting and recordkeeping procedures should be required for all contractors and subcontractors utilizing GFP.**

The accounting for GFP can be easily automated utilizing a real-time data processing system to account for Government Property receipts, issues, and transfers.

This system would greatly facilitate the annual submission of the DD FORM 1662, account for any commercial usage of GFP, and identify GFP on plant clearance schedules. Government Property Administrators should have access to this uniform system. The automated system should be installed only after performing a cost-benefit analysis to demonstrate cost effectiveness.

By requiring subcontractors to utilize this uniform system, visibility of GFP in their facilities would greatly improve.

8. **Contract close-out should receive a higher priority and procedures should be modified to: (1) ensure the ACO has the sole authorization to dispose of excess GFP; (2) incorporate contract provisions concerning forced dispositions for GFP to prevent property from simply transferring between contracts at the same contractor's facility; (3) include additional classes of property in the automatic disposition procedures for excess property; and (4) include specific disposition instructions for GFP in the contract at time of award.**

This recommendation is based upon the tenet that less GFP in the contractor's possession requires less accounting for potential commercial use. Disposition instructions should be simplified.

9. **Property Administrators should be excluded from DOD-wide hiring freezes.**

High personnel turnover is characteristic of a Government career field where the highest grade level is a GS-13. Personnel tasked with protecting and accounting for the Government's \$64.4 (+) billion investment in property should not be subjected to manpower shortages due to Department-wide hiring freezes. Several contractor Property Administrators agreed that the Government is losing visibility over its property because of the manpower shortages in this career field. Several Government Property

Administrator complained that they can only spend a few hours each year in each contractor's facility because of the manpower shortage.

10. **The Government Property Council should review applicable sections of all Services and agency directives and regulations to clarify conflicting and ambiguous language pertaining to the management of GFP.**

What is the purpose of this Council if they fail to provide clear, concise directions to field activities and contractors regarding the proper management of GFP? Several Property Administrators complained of conflicting directives and regulations.

11. **Supply depots should strengthen transfer procedures to reduce duplicate shipments of GFP to contractors' facilities and to ensure all information on the DD FORM 1348 shipping documents is accurate and complete.**

Property administrators depend upon the information provided by the supply depots when accounting for the GFP in their possession and for accurately accounting for the commercial usage of this property. If inaccurate or incomplete information is provided on the shipping documents, inaccurate and incomplete information will be used to account for the GFP in the contractors' and subcontractors' facilities. This inaccurate and incomplete information would further be reported on the DD FORM 1662.

12. **A separate category for automatic data processing equipment (ADPE) should be established on Government utilization surveys to facilitate accurate accounting for this type of GFP.**

Automatic data processing equipment is not OPE, IPE, ST, or STE and because there is currently no accounting category for ADPE, the Government Property Administrators have to classify it as one of the above on the utilization surveys. This causes an inaccurate, incomplete, and inconsistent reporting of ADPE throughout DOD.

13. **PCOs should authorize ACOs to handle all contractual responsibilities for contractors utilizing GFP for commercial purposes.**

When both the PCO and the ACO are involved in the management of GFP, contractors often receive conflicting instructions. By shortening the communication pipeline between the contractor and the field activity, the potential for conflicting instructions and accounting requirements is greatly decreased.

14. **Property Administrators should be trained in the implementation of Material Control Activities (MCAs).**

Only three of the 50 Property Administrators interviewed in February 1991 were familiar with MCAs despite the implementation of this DOD-wide program in October 1990. This system is designed to control Defense contractors' access to the Services' supply systems. Property Administrators should be informed as to its goals and procedures.

15. **Government and contractor Property Administrators should be included in the ACO's team when approving a Defense contractor's MMAS.**

The Property Administrators are the material managers. They should be intimately involved in all MMAS implementation decisions.

D. AREAS FOR ADDITIONAL RESEARCH

The following are recommended topics for further research:

1. **Research the accountability of GFP at Defense subcontractor facilities.**
2. **Research the effectiveness of the Material Management Accounting System (MMAS).**

3. Develop a computer program to provide online access to GFP inventory information for both industry and Government Property Administrators and facilitate production of the DD FORM 1662 - Annual accounting for the Government Property in the custody of contractors.
4. Research the recommendation of charging contractors rental fees when the contractor fails to use the GFP for a certain period of time.
5. Research the cost effectiveness of cross referencing contractor part numbers to national stock numbers prior to submitting excess property screenings.
6. Research whether a separate contract for the commercial use of GFP would be more cost effective than simply including the provisions in the production contract.
7. Research the excess property disposition procedures to determine if a more effective and efficient method of disposing excess property is feasible.
8. Research the cost effectiveness break-even point for returning excess material back into the Defense supply systems.

APPENDIX A

STATEMENT

BY

MR. FRANK C. CONAHAN

ASSISTANT COMPTROLLER GENERAL

NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

ON

MARCH 21, 1988

Mr. Chairman and members of the Committee:

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

RESULTS IN BRIEF

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

Several factors contribute to the problems in controlling and accounting for property furnished to contractors. First, DOD has not effectively implemented the basic government policy of relying on contractors to provide all the property needed for

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

government contracts, except when it can be demonstrated that it is in the government's best interest to furnish it. Second, the Services have not yet implemented or have inadequately implemented DOD instructions designed to control contractor access to the DOD supply system. Third, DOD has not adequately enforced the provisions of the Federal Acquisition Regulation (FAR), which require that contractors account for and safeguard government property in their possession. Fourth, DOD and the Services have not yet implemented financial accounting systems that would give them independent data for judging whether contractors' records are accurate. In our opinion, these factors need to be adequately addressed to ensure that the potential for fraud, waste, and abuse is minimized, maximum benefits accrue to the government, and the government's sizeable investment in property is safeguarded and protected.

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

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

BACKGROUND

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

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

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

Defense Component	Government Material (billions)	Government Equipment (billions)	Total (billions)
Army	2.4	3.4	5.8
Navy	7.7	2.7	10.4
Air Force	6.0	4.1	10.1
Other	---	0.1	0.1
Total	\$16.1	\$10.3	\$26.4

Government material consists of those items provided from the DOD supply system as government-furnished material (GFM), and items purchased by the contractor with government funds from commercial sources, commonly referred to as contractor-acquired

material (CAM). Our review work focused on GFM, except in those instances when the GFM and CAM could not be readily segregated in the contractor's records.

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

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

To enable certain contractors to requisition, receive, and be billed for GFM, the Services assign them six digit codes, called DOD Activity Address Codes (DODAACs). These contractors are authorized to use their DODAACs and follow standard DOD requisitioning procedures to obtain materials directly from wholesale level supply inventories.² Other contractors obtain material directly by ordering from on-base supply

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

activities, which replenish their stocks from the wholesale inventories, or by having a service's organization order the material directly from the wholesale level which then turns the material over to the contractor for his use.

The FAR and contract provisions prescribe that contractors are responsible for establishing and maintaining systems to control, protect, preserve, and maintain all government property, including GFM. These systems are subject to review and approval by DOD property administrators. To do this, property administrators are to perform annual surveys of the systems. The surveys are divided into 10 categories ranging from property acquisition, use, and consumption to receiving and record keeping. Deficiencies noted during these surveys are to be reported to the contractor for prompt corrective action. If a contractor fails to establish and maintain an effective property control system, the government can disapprove the system, and the contractor can be held liable for future losses or damage to government property.

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

**GOVERNMENT-FURNISHED MATERIAL: NEED FOR BETTER
MANAGEMENT CONTROLS, OVERSIGHT, AND ACCOUNTABILITY**

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

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

Lack of compliance with government policy on providing material

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

DOD policy contained in DOD Instruction 4140.48 (Control of Access to DOD Material Inventories Required By Defense Contracts), DOD Instruction 4100.33 (Commercial Activities Program Procedures), and various service directives state that decisions to provide material should be supported by sound rationale and be documented

in writing. However, commands and activities we visited were generally not complying with the policy for reasons ranging from being unaware of existing DOD and service policies in this area to following past practices, which presumed that it was inherently less costly and troublesome for the government to provide materials to contractors than for contractors to buy it commercially. For example:

--We reviewed 19 maintenance contracts at 3 Air Force Air Logistics Centers, but only 1 of them contained a written justification for GFM. Officials at one Air Logistics Center stated that none of its 201 maintenance contracts contained the required justifications.

Some personnel were not aware of the policy on GFM, and others followed an outdated (1978) regulation, which stated that the government would normally provide, as GFM, parts available in the DOD supply system. This regulation was revised in 1984.

--We reviewed 8 randomly selected maintenance contracts at the Navy's Aviation Supply Office, but none contained written documentation to support the decision to provide GFM, as required by Navy policy. The Supply Office inventory managers said that in recent years they had followed the practice of providing contractors with all material necessary for contract performance.

--Although DOD had a policy since at least 1985 requiring contractors to provide all material necessary to accomplish their service contracts, we found that, with few exceptions, service contracts at Army, Navy, and Air Force installations authorized that all material needed by contractors would be provided as GFM. This happened, even though some of the material was readily available from commercial sources and could be obtained at lower cost. Material provided as GFM included such items as paint, lumber, common hardware, car wax, office and automotive supplies, and videotapes.

On the cost issue, we found instances where contractors could obtain material from commercial sources at substantially lower cost than from the DOD supply system. For example:

--One Air Force contractor was authorized to buy 18 air compressor doors commercially because they were not in stock in the DOD supply system. He obtained the doors for \$21 each commercially, whereas the DOD catalog price was \$253.

--Another Air Force contractor obtained numerous electronic components commercially at a price less than half of the DOD catalog price. He was required by his contract to identify the most economical source and then either buy the parts commercially and be reimbursed or requisition them from the DOD supply system. During fiscal year 1986, the contractor obtained about 90 percent of his \$16.4 million of material from commercial sources.

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

Inadequate controls over the issuance of GFM to contractors

In response to the reports of numerous abuses of DOD policies shown in attachment I [not included] and various congressional reports resulting from hearings on this subject, DOD issued an instruction (DODI 4140.48) in March 1981. This instruction required the Services to establish one or more management control activities (MCA) to maintain control over maintenance contractors' access to the DOD supply system by reviewing, validating, and approving contractor requests for GFM. DOD expected implementation of this instruction by November 1982. In March 1986 DOD issued a revised instruction that expanded the scope to all types of contracts, including both base and centrally

awarded service, production, and research and development contracts. However, the instructions have either lacked full implementation by the Services or implementation procedures and practices have been ineffective. For example, with respect to maintenance contractors:

--The Army has not yet implemented MCA controls as envisioned by DOD because it has not completed development of an automated system it believes is needed to effectively implement such controls. According to Army officials, contributing factors that slowed MCA implementation were limited coordination between Army organizations involved in supply and contracting and a lack of resources thought necessary to establish and maintain MCAs. DOD projects full Army MCA implementation by June 1989.

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

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

--The Air Force has not properly implemented a regulation that requires the identification of specific parts and quantities needed by contractors to execute maintenance contracts. As a result, contractors have had access to and have ordered unneeded material. For example, in its 1986 report on the effectiveness of internal controls on GFM, the Air Force Audit Agency tested 180 out of a total of 1,037 contractor requisitions during a 2-month period (November and December 1984). Of the 180 requisitions, 33 were for unauthorized/unneeded items valued at \$334,000. The Air Force concurred and stated that new procedural guidance would be issued by January 1986. However, our review should that the potential for obtaining unneeded/unauthorized items still exists.

--The MCA system currently has no checks to prevent a contractor from exceeding maximum part quantities needed to perform a contract, and contractors can avoid edits designed to prevent them from depleting inventory stock levels. For example, one contractor had submitted 45 requisitions, each for 19 electrical parts, for a total of 855 on the same day. The contract limited the contractor to 90 parts. The contractor avoided the maximum quantity of 20 items per requisition for this part by ordering one less part on each request. The multiple contractor requisitions depleted the entire DOD inventory of these parts.

--Some Air Force contractors have obtained GFM without prior MCA review and approval by accessing the supply source directly. For example, the Air Force Audit Agency reported in 1986, that 161 out of a total of over 81,000 material requisitions were filled in this manner. The material obtained was valued at \$137,000. Of the 161 requisitions, 107 requisitions that were submitted by one contractor, valued at about \$95,000, were determined by the Air Force Audit Agency to be improper and were referred to the Air Force Office of Special Investigations for further assessment.

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

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

Weaknesses in controls over material after issuance to contractors

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

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

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

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

Navy and contractor officials agreed that there was potential excess GFM. They are now determining the exact amount of excess material and what to do with it. Contractor officials also agreed that the property control system problems were long-standing and said that they would take corrective action.

--Another Navy contractor, who had accumulated \$2.4 million of potential excess GFM under one contract, did not record more than \$670,000 of GFM on its property records. The government was not aware of this omission, since there was no government property administrator assigned during fiscal year 1986. The property administrator told us that during fiscal year 1987, he was not given the authority by the contracting officer to review the contract and the contracting officer did not have the staff to do it.

Contractor personnel agreed that they should have accounted for the material until it was actually used and said they would begin accounting for GFM in this fashion.

--A May 1985 Naval Audit Service report stated that a contractor with over \$303 million of government-furnished property, including \$36 million of GFM, operated with outdated and incomplete property control procedures. Some of the procedures, which had been approved in the early 1970s, had not been updated. The report concluded that, as a result, there was no assurance that the property was adequately controlled.

--The Naval Audit Service in an August 1986 report stated that, although the property administrator's annual surveys showed that a contractor adequately controlled his \$526 million of GFM, substantial quantities of excess material (\$146 million) may have accumulated. This condition existed because inventory tests performed by the property administrator were done only to verify that material issued from government stocks was authorized. Such tests would not detect excess material on a program-wide basis. The Navy concurred with the report and has (1) transferred \$30 million of the excess inventory to other users, (2) disposed of \$5 million because it was obsolete, and (3) agreed to review the remaining excesses.

--At an Air Force contractor, the government property administrator was not aware that between November 1985 and October 1986 the contractor had requisitioned about \$102,000 of GFM, from 27 federal stock classes, which was not *authorized in the contract*. As the same contractor plant, the property administrator also did not routinely review GFM stock on hand to identify excess inventory, as required in the contract, because the contractor's GFM inventory status report to the responsible Air Logistics Center lacked sufficiently detailed information on such things as descriptions, part replacement rates, and item costs. Over \$360,000 of GFM was on hand in early 1987, and a contractor official believed that most of it was excess to existing needs.

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

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

The Air Force Audit Agency made similar observations in its 1987 report on GFM controls at contractor facilities. The Agency reported that from six Air Force Plant Representative Offices reviewed, none of the property administrators used the shipment lists. Instead they used contractor receiving documents to reconcile contractor GFM balances. The Agency attributed this to Air Force Contract Management Division directives that did not incorporate the March 1981 and 1986 DODI 4140.48 procedures for independent verification.

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

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

Accountability and financial controls

Since 1967, we--as well as congressional committees--have criticized DOD and the Services for not having established property accountability and financial accounting controls over GFM. We recommended in two reports that DOD and the Services establish accounting systems that adequately account for (1) the quantity and value of government material authorized and provided to contractors and (2) the receipt and use of this material by contractors.

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

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

collection effort for fiscal year 1986 and reported its result. It is now working on fiscal year 1987 data.

While the actions taken by DOD in the property accountability area are steps in the right direction, we have concerns with the accuracy and completeness of the data reported. Our review of the 1986 DOD property report disclosed that it was incomplete, because not all contractors with property had submitted the required data. For example, three Navy contractors we reviewed, who had about \$21.2 million of GFM under three contracts, had not reported the necessary data. Another Navy contractor who had reported did not include two contracts with material valued at about \$22.5 million in his data submission. The same contractor also did not include GFM values for over 56,500 line items out of a total of over 65,700 line items on 4 other contracts. The value of the remaining 9,200 line items was about \$59.6 million. In addition, a 1987 Naval Audit Service report disclosed that a contractor had overstated the GFM value on his records by \$1.5 billion. The report also pointed out that the Audit Service could not account for an additional \$900 million of government property recorded in the contractor's property system.

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

Agency reported in 1987 that the Air Force provided an estimated \$11.5 billion of GFM during fiscal year 1985 to contractors.

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

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

GOVERNMENT FURNISHED EQUIPMENT: MANAGEMENT AND CONTROL PROBLEMS CONTINUE BUT IMPROVED ACTIONS ARE UNDERWAY

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

One most recent work in the GFE area resulted in a June 1986 report to the Secretary of Defense entitled Government Equipment: Defense Should Further Reduce the Amount it Furnishes to Contractors. This report advised the Secretary that management oversight problems reported on in the past had remained essentially unchanged and that little progress had been made by DOD in implementing overall

government policies that call for minimizing the amount of equipment the government furnishes to contractors. More specifically, the report pointed out that several major factors had impeded progress, including:

- vague FAR and Defense FAR Supplement provisions, which had allowed government officials to permit contractors to acquire new, general purpose equipment such as office equipment and vehicles;

- limited Defense efforts to motivate contractors to provide their own equipment;

- inadequate equipment acquisition guidelines, especially for service contractors; and

- continuing management oversight problems at field and headquarters levels over the acquisition, use, retention, and disposal of GFE.

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

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

- the Defense Acquisition Regulatory Council to take steps to amend the DOD FAR Supplement to allow the military Services and defense agencies to provide general purpose equipment to contractors only under highly unusual circumstances, which are clearly defined, adequately controlled, and properly justified;

- his office and the Army, Navy, and Air Force to develop specific guidelines for program managers and local contracting officials to use in determining when and under what conditions the government can provide general purpose equipment to service contractors;

--the three Services to (1) identify general purpose plant equipment acquired by contractors under other than facilities contracts and (2) determine and recoup any improper profits or fees that were added as a result of such acquisitions;³

--the Army and the Navy to undertake comprehensive reviews of their government-owned, contractor-operated plants to determine which ones could be sold, and then to consummate such sale;

--his office to establish an adequately staffed central office for government-furnished property, including GFE. This central office should have, at a minimum, information on the quantity and value of GFE acquired annually by each service, how it is being used, and how much is being discarded. In support of this office, each service secretary should designate a focal point responsible for the overall management of government-furnished property within the service.

DOD AND SERVICE INITIATIVES

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

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

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

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

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

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

--DOD has not effectively implemented the basic government policy of relying on contractors to provide all the property needed for government contracts, except when it can be demonstrated that it is in the government's best interest to do so.

--The DOD and service regulations designed to control contractor material requisitions submitted to the DOD supply system have either not been implemented or were inadequately implemented.

--The provisions of the FAR that require contractors to account for and safeguard government property in their possession and the government to maintain oversight over the contractor's management of the property have not been adequately enforced.

--DOD and the Services have made slow progress in developing and implementing financial property accounting systems, which would give the government independent data for judging the accuracy of the contractors' records.

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

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

APPENDIX B

THE MATERIAL MANAGEMENT ACCOUNTING SYSTEM

Element 1.

Have an adequate system description including policies, procedures, and operating instructions compliant with the FAR and DFARS.

Element 2.

Assure that costs of purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements as impacted by minimum/economic order quantity restrictions. A 98 percent bill of material accuracy and a 95 percent master production schedule accuracy are desirable as a goal in order to assure that requirements are both valid and appropriately timephased. If systems have accuracy levels below those above, the contractor must demonstrate that (i) there is no material harm to the Government due to lower accuracy goals is excessive in relation to the impact on the Government.

Element 3.

Provide a mechanism to identify, report, and resolve system control weaknesses such as excess/residual inventory as soon as known.

Element 4.

Provide audit trails and maintain records necessary to evaluate system logic and to verify through transaction testing that the system is operating as desired. Both manual records and those in machine readable form will be maintained for the prescribed record retention periods.

Element 5.

Establish and maintain adequate levels of record accuracy, and include reconciliation of recorded inventory quantities to physical inventory by part number on a periodic basis. A 95 percent accuracy level is desirable. If systems have an accuracy level below 95 percent, the contractor must demonstrate that (i) there is no material harm to the Government due to lower accuracy level, and/or (ii) the cost to meet the accuracy goal is excessive in relation to the impact on the Government.

Element 6.

Provide detailed description(s) of circumstances which will result in manual or system generated transfers of parts.

Element 7.

Maintain a consistent, equitable, and unbiased logic for costing of material transactions. The contractor will maintain and disclose a written policy describing the transfer methodologies. The costing methodology may be standard or actual cost, or any of the inventory costing methods in FAR 30.411-50(b). Consistency must be maintained across all contract and customer types, and from accounting period to accounting period for initial charging and transfer charging.

(i) The system should transfer parts and associated costs within the same billing period.

(ii) In the few circumstances where it may not be appropriate to transfer parts and associated costs within the same billing period, use of a "loan/payback" technique must be approved by the ACO. When the technique is used, there must be controls to ensure that parts are paid back expeditiously; procedures and controls are in place to correct any overbilling that might occur; at a minimum, the borrowing contract and the date the part was borrowed are identified monthly; and the cost of the replacement part is charged to the borrowing contract.

Element 8.

Where allocations from common inventory accounts are used, have controls in addition to the requirements of standards in paragraphs (b)(2) and (7) above to ensure that:

(i) Reallocations and any credit due are processed no less frequently than the routine billing cycle;

(ii) Inventories retained for requirements which are not under contract are not allocated to contracts;

(iii) Algorithms are maintained based on valid and current data.

Element 9.

Notwithstanding FAR 45.505-3(f)(2)(ii), have adequate controls to ensure that physically commingled inventories that may include material for which costs are charged or allocated to fixed-price, cost-reimbursed, and commercial contract do not comprise the requirements of any of the above standards.

Element 10.

Be subjected to periodic internal audits to ensure compliance with established policies and procedures.

APPENDIX C

FAR 52.245-9: THE USE AND CHARGES CLAUSE

As prescribed in 45.302-6(c), insert the following clause in solicitations and contracts (1) when a consolidated facilities contract or a facilities use contract or (2) when a fixed price contract is contemplated, and Government production and research property is provided other than on a rent-free basis. If the conditions specified in 45.403(a) apply, the contracting officer shall modify the clause as appropriate.

USE AND CHARGES (APR 1984)

- (a) The Contractor may use the facilities without change in the performance of-
 - (1) Contracts with the Government that specifically authorize such use without charge;
 - (2) Subcontracts of any tier under Government prime contracts if the Contracting Officer having cognizance of the prime contracts (i) approves a subcontract specifically authorizing such use or (ii) otherwise authorizes such use in writing; and
 - (3) Other work, if the Contracting Officer specifically authorizes in writing use without charge for such work.
- (b) If granted written permission by the Contracting Officer, or if it is specifically provided for in the Schedule, the Contractor may use the facilities for a rental fee for work other than that provided in paragraph (a). Authorizing such use of the facilities does not waive any right to use the facilities. The rental fee shall be determined in accordance with the following paragraphs.
- (c) The following bases are or shall be established in writing for the rental computation prescribed in paragraphs (d) and (e) below in advance of any use of the facilities on rental basis:
 - (1) The rental rates shall be those set forth in Table I.
 - (2) The acquisition cost of the facilities shall be the total cost to the Government, as determined by the Contracting Officer, and includes the cost of transportation and installation, if borne by the Government.
 - (i) When Government-owned special tooling or accessories are rented with any of the facilities, the acquisition cost of the facilities shall be increased by the total cost to the Government of such tooling or accessories, as determined by the Contracting Officer.

- (ii) When any of the facilities are substantially improved at Government expense, the acquisition cost of the facilities shall be increased by the increase in value that the improvement represents, as determined by the Contracting Officer.
 - (iii) The determinations of the Contracting Officer under this subparagraph (c)(2) shall be final.
 - (3) For the purpose of determining the amount of rental due under paragraph (d), the rental period shall not be less than 1 month nor more than 6 months, as approved by the Contracting Officer.
 - (4) For the purpose of computing any credit under paragraph (e), the unit in determining the amount of use of the facilities shall be direct labor hours, sales, hours of use, or any other unit of measure that will result in an equitable apportionment of the rental charge, as approved by the Contracting Officer.
- (d) The Contractor shall compute the amount of rentals to be paid for each rental period by applying the appropriate rental rates to the acquisition cost of such facilities as may have been authorized for use in advance for the rental period.
- (e) The full rental charge for each period shall be reduced by a credit. The credit equals the rental amount that would otherwise be properly allocable to the work for which the facilities were used without charge under paragraph (a). The credit shall be computed by multiplying the full rental for the rental period by a fraction in which the numerator is the amount of use of the facilities by the Contractor without charge during the period, and the denominator is the total amount of use of the facilities by the Contractor during the period.
- (f) Within 90 days after the close of each rental period, the Contractor shall submit to the Contracting Officer a written statement of the use made of the facilities by the Contractor and the rental due the Government. At the same time, the Contractor shall make available such records and data as are determined by the Contracting Officer to be necessary to verify the information contained in the statement.
- (g) If the Contractor fails to submit the information as required in paragraph (f) above, the Contractor shall be liable for the full rental for the period. However, if the Contractor's failure to submit was not the fault of the Contractor, the Contracting Officer shall grant to the Contractor in writing a reasonable extension of time to submit.
- (h) Unless otherwise directed in writing by the Contracting Officer, the Contractor shall give priority in the use of the facilities to performing contracts and subcontracts of the Contracting Officer having cognizance of the facilities and shall not undertake any work involving the use of the facilities that would interfere with performing existing Government contracts or subcontracts.

(i) Concurrently with the submission of the written statement prescribed by paragraph (f) of this clause, the Contractor shall pay the rental due the Government under this clause. Payment shall be by check made payable to the office designated for contract administration and mailed or delivered to the Contracting Officer. Receipt and acceptance by the Government of the Contractor's check pursuant to this paragraph shall constitute an accord and satisfaction of the final amount due the Government hereunder, unless the Contractor is notified in writing within 180 days following receipt that the amount received is not regarded by the Government as the final amount due.

(j) If the Contractor uses any item of the facilities without authorization, the Contractor shall be liable for the full monthly rental, without credit, for such item for each month or part of a month in which such unauthorized use occurs; provided, however, that the agency head concerned may, in writing, waive the Contractor's liability for such unauthorized use if the agency head determines that without such a waiver gross inequity would result. This acceptance of any rental by the Government under this clause shall not be construed as a waiver or relinquishment of any rights it may have against the Contractor growing out of the Contractor's unauthorized use of the facilities or any other failure to perform this contract according to its terms.

TABLE I
Rental Rates

(i) For real property and associated fixtures, a fair and reasonable rental shall be established, based on sound commercial practice.

(ii) For plant equipment of the types covered in Federal Supply classes 3405, 3408, 3410, and 3411 through 3419, machine tools; and in 3441 through 3449, secondary metal forming and cutting machines, the following monthly rates shall apply:

<u>Age of Equipment</u>	<u>Monthly Rental Rate</u>
Under 2 years old.....	3.0 percent
Over 2 to 3 years old.....	2.0 percent
Over 3 to 6 years old.....	1.5 percent
Over 6 to 10 years old.....	1.0 percent
Over 10 years old.....	0.75 percent

The age of each item of the equipment shall be based on the year in which it was manufactured, with a birthday on January 1 of each year thereafter. For example, an item of equipment manufactured on July 15, 1978, will be considered to be "over 1 year old" on and after January 1, 1979, and "over 2 years old" on and after January 1, 1980.

(iii) For personal property and equipment not covered in (i) or (ii) above, a rental shall be established at not less than the prevailing commercial rate, if any, or in the absence of such rate, not less than 2 percent per month for electronic test equipment and automotive equipment and not less than 1 percent per month for all other property and equipment.

(End of clause)
(R 7-702.12 1976 OCT)

APPENDIX D

LIST OF TELEPHONE INTERVIEWS WITH PROPERTY ADMINISTRATORS

1. Allen, R., General Dynamics Corp., San Diego, CA, 22 February 1991.
2. Amos, J., FMC Corp., San Jose, CA, 21 February 1991.
3. Anderson, L., E-Systems Inc., Greenville, TX, 22 February 1991.
4. Archer, J., DPRO Westinghouse, Cleveland, OH, 21 February 1991.
5. Brown, R., Hughes Corp., Fullerton, CA, 21 February 1991.
6. Camp, R., DPRO Rockwell Intl., Richardson, TX, 21 February 1991.
7. Carter, B., DPRO AT&T Technologies, Inc., Burlington, NC, 21 February 1991.
8. Cortez, S., DPRO Northrop Corp., Hawthorne, CA, 21 February 1991.
9. Craig, R., DPRO General Dynamics Corp., San Diego, CA, 22 February 1991.
10. Curry, G., DPRO IBM Corp., Owego, NY, 27 February 1991.
11. Dante, J., DPRO Aerojet-General Corp., Sacramento, CA, 22 February 1991.
12. Diagiaco, A., DPRO Harris Corp., Syosset, NY, 22 February 1991.
13. Gagante, N., DPRO FMC Corp., San Jose, CA, 27 February 1991.
14. Gillender, W., Pratt & Whitney Corp., West Palm Beach, FL, 22 February 1991.
15. Green, E., DPRO Martin Marietta Corp., Orlando, FL, 22 February 1991.
16. Gregory, I., Bell Helicopter-Textron Corp., Fort Worth, TX, 22 February 1991.
17. Grotefend, M., Litton Data Systems Corp., Woodland Hills, CA, 21 February 1991.
18. Hoffman, H., DPRO McDonnell Douglas Corp., Huntington Beach, CA, 27 February 1991.

19. Hogan, V., DPRO Ford, Newport Beach, CA, 22 February 1991.
20. Johnson, L., DPRO Texas Instruments, Dallas, TX, 21 February 1991.
21. Johnson, N., Westinghouse Corp., Cleveland, OH, 22 February 1991.
22. Levitte, J., DPRO Northrup Corp., Hawthorne, CA, 21 February 1991.
23. McCallister, C., DPRO Pratt & Whitney, West Palm Beach, FL, 22 February 1991.
24. McConnell, J., DPRO General Electric Corp., Lynn, MA, 21 February 1991.
25. McFarland, R., General Dynamics Corp., Dallas, TX, 27 February 1991.
26. Menaugh, H., DPRO Litton Data Systems Corp., Woodland Hills, CA, 21 February 1991.
27. Miles, E., DPRO Bell Helicopter-Textron Corp., Fort Worth, TX, 21 February 1991.
28. Minich, J., DPRO Magnavox Corp., Fort Wayne, IN, 22 February 1991.
29. Morrow, P., DPRO General Dynamics Corp., Pomona, CA, 22 February 1991.
30. Muratt, T., ITT Corp., Nutley, NJ, 22 February 1991.
31. O'Brian, M., DPRO GTE Government Systems Corp., Needham, MA, 22 February 1991.
32. Owen, C., AT&T Technologies Corp., Burlington, NC, 22 February 1991.
33. Peckerman, L., DPRO Unisys Corp., Great Neck, L.I., NY, 22 February 1991.
34. Perry, R., Rockwell, International Corp., El Segundo, CA, 27 February 1991.
35. Pilat, M., DPRO Marysville, Marysville, OH, 22 February 1991.
36. Potter, J., Bell Helicopter-Textron Corp., Fort Worth, TX, 27 February 1991.
37. Pratt, H., GTE Government Systems Corp., Needham, MA, 27 February 1991.
38. Ramsey, W., Loral Aeronutronics Division, Newport Beach, CA, 27 February 1991.
39. Ramsey, M., DPRO E-Systems Inc., Greenville, TX, 21 February 1991.

40. Raynor, A., DPRO Lockheed Aeronautical Systems Co., Marietta, GA, 21 February 1991.
41. Rogers, C., Todd Shipyards, Seattle, WA, 27 February 1991.
42. Rudenick, J., DPRO Minneapolis, Minneapolis, MN, 21 February 1991.
43. Smey, M., DPRO Teledyne CAE, Toledo, OH, 22 February 1991.
44. Stenehjem, A., FMC Naval Systems Corp., 22 February 1991.
45. Thompson, T., DPRO Hughes Corp., Fullerton, CA, 21 February 1991.
46. Toombs, B., Martin Marietta Corp., Orlando, FL, 27 February 1991.
47. Vernon, D., Texas Instruments Corp., Dallas, TX, 22 February 1991.
48. Wagenheim, R., Martin Marietta Corp., Orlando, FL, 27 February 1991.
49. Wright, M., DPRO Westinghouse Corp., Sunnyvale, CA, 27 February 1991.
50. Zygodlo, E., DPRO ITT Defense Group, Nutley, NJ, 21 February 1991.

LIST OF REFERENCES

1. Goetz, Douglas N. "The Classification of Government Property." (unpublished paper.)
2. Contract Management, Button, Button, Who Owns the Button?, by Cory M. Ridner, Volume 29, October 1989.
3. Sherman, Stanley, Contract Management Post Award, WordsCrafters Publication, Gaithersburg, Maryland, 1987.
4. South Boston Iron Works vs. United States, 34 CT. Cl. 174 (1899).
5. Rose, Richard D. Contract Investment Requirements of Negotiated Contracts. Thesis. George Washington Univ.: University Microfilms Intl., 1972.
6. The Industry - Government Aerospace Relationship. Menlo Park, California: The Stanford Research Institute, 1963.
7. Government Contract Law. U.S. Air Force Air University, Air Force Institute of Technology, School of Systems and Logistics, 1985.
8. National Contract Management Journal, Government Furnished Property: Government Furnished Problems, by Terence M. Cleary, Volume 22, Winter 1989.
9. National Contract Management Journal, A Case of Neglect: The Management of Government Property, by Jack E. Simon, Volume 12, 2nd Quarter, 1978.
10. U.S. General Accounting Office, DOD's Management of the Property It Furnishes to Contractors, Report No. NSIAD-88-151, U.S. Government Printing Office, Washington, D.C., May, 1988.
11. Kordes, J., Deputy for Property Policy and Programs, Office of the Assistant Secretary of Defense (Production and Logistics), Washington, D.C., telephone interview granted December 7, 1990.
12. U.S. Senate: Hearing before the Committee on Governmental Affairs, One Hundredth Congress, Second Session, Government Furnished Property Provided to DOD Contractors. March 21, 1988, U.S. Government Printing Office, Washington, D.C., 1988.

13. U.S. House of Representatives: Hearing before the Committee on Government Operations, Ninety-ninth Congress, Second Session, Misuse of Government Equipment in Defense Production. April 26, 1986, U.S. Government Printing Office, Washington, D.C., 1986.
14. Gigliotti, Robert R. "Financial Analysis of Major Defense Contractors." Report by RRG Associates for the Assistant Secretary of the Navy (Shipbuilding and Logistics). Washington, D.C., 1985.
15. Harvard Business Review, Getting Things Done: Sharpening Inventory Management, by D.J. Armstrong, November - December 1985.
16. Plossl, G.W. and O.W. Wight, Production and Inventory Control. 1st ed. New Jersey: Prentice-Hall, 1967.
17. Dobler, Donald W., David N. Burt, and Lamar Lee, Jr., Purchasing and Materials Management. 5th ed., New York: McGraw-Hill, 1990.
18. U.S. House of Representatives, Hearing before the Readiness Subcommittee of the Committee on Armed Services, One Hundredth Congress, First Session, Material Requirements Planning Systems. May 13, 21, June 11, 18, July 14, 21 1987, U.S. Government Printing Office, Washington, D.C., 1988.
19. U.S. Department of Defense. Annual Report to the Congress Fiscal Year 1988. U.S. Government Printing Office, Washington, D.C., 1987.
20. Johnson, M., Office of the Assistant Secretary of the Navy (Research, Development, and Acquisition), Washington, D.C., telephone interview granted January 21, 1991.
21. Steensma, D., Director of Contract Management, Office of the Department of Defense Inspector General, Washington, D.C., telephone interview granted January 14, 1991.
22. U.S. Department of Defense, The Department of Defense Manual for the Performance of Contract Property Administration, DOD 4275.1-M, U.S. Government Printing Office, Washington, D.C., 1990.
23. Goetz, Douglas N. "The Material Management Accounting System." (unpublished paper.)
24. U.S. Department of Defense, Department of Defense Federal Acquisition Regulation Supplement, U.S. Government Printing Office, Washington, D.C., January 1986.
25. Federal Acquisition Regulation, U.S. Government Printing Office, Washington, D.C., 1984.

INITIAL DISTRIBUTION LIST

	No. Copies
1. Defense Technical Information Center Cameron Station Alexandria, Virginia 22304-6145	2
2. Defense Logistics Studies Information Exchange U.S. Army Logistics Management Center Fort Lee, Virginia 23801	1
3. Library, Code 52 Naval Postgraduate School Monterey, California 93943-5002	2
4. Dr. D. V. Lamm, Code AS-Lt Department of Administrative Sciences Naval Postgraduate School Monterey, California 93943-5000	5
5. CDR Rodney F. Matsushima, SC, USN, Code AS-My Department of Administrative Sciences Naval Postgraduate School Monterey, California 93943-5000	2
6. LT D. F. Baucom, SC, USN 7603 Ruxton Drive Springfield, Virginia 22153	2
7. Curricular Officer, Code AS Department of Administrative Sciences Naval Postgraduate School Monterey, California 93943-5000	1