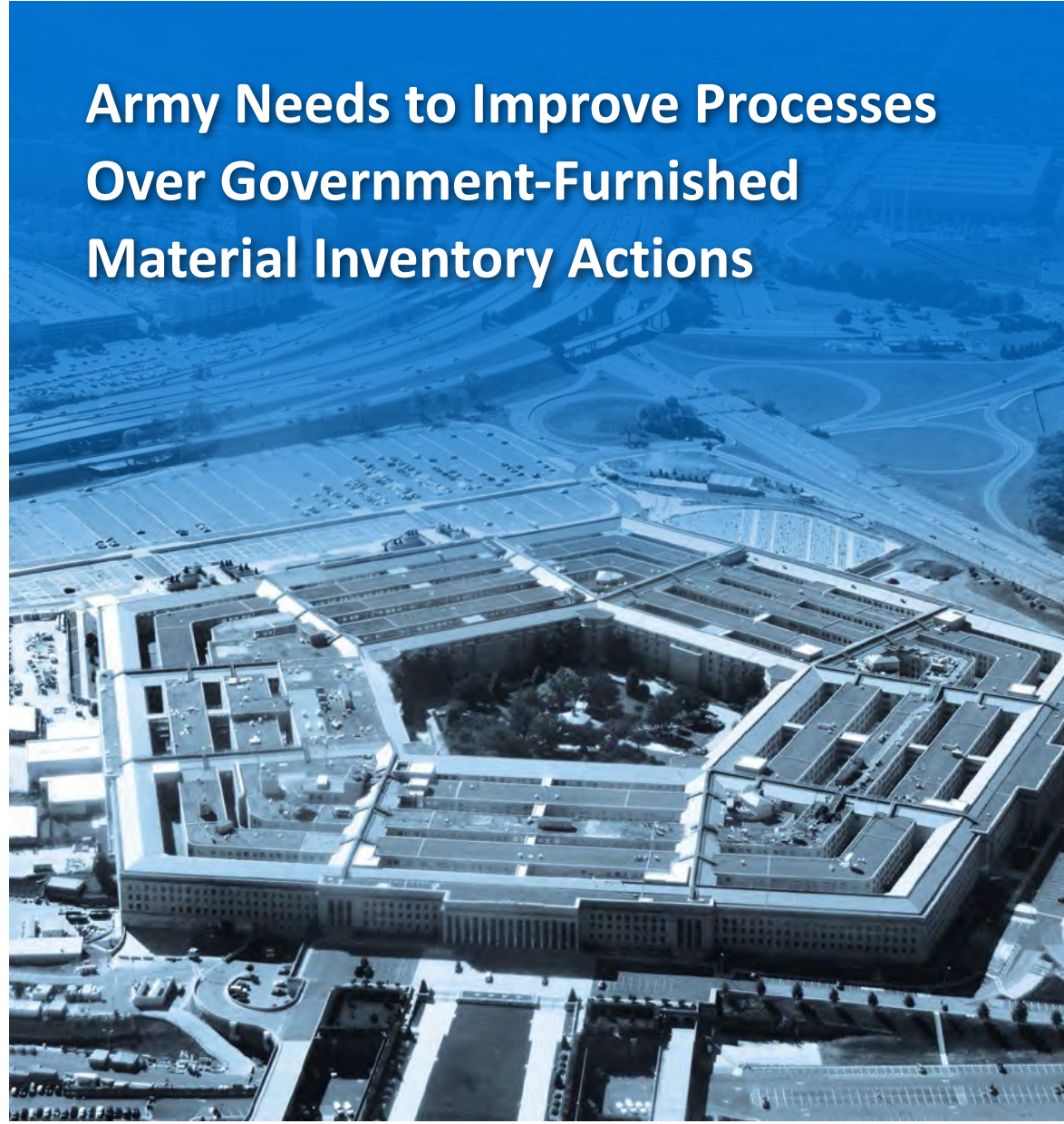




INSPECTOR GENERAL

U.S. Department of Defense

MAY 21, 2015



Army Needs to Improve Processes Over Government-Furnished Material Inventory Actions

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

Report Documentation Page

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Results in Brief

Army Needs to Improve Processes Over Government-Furnished Material Inventory Actions

May 21, 2015

Objective

We determined whether the Logistics Modernization Program (LMP) system correctly recorded Army inventory actions for Government-furnished material (GFM) in the general ledger accounts and accountability records.

Finding

The Army did not correctly record GFM inventory actions in Army financial and accountability records. Specifically, in FY 2014, Army Working Capital Fund (AWCF) activities expensed about \$40.2 million in GFM upon shipment to contractors. This occurred because Assistant Secretary of the Army (Financial Management and Comptroller) (ASA[FM&C]) and Army Materiel Command (AMC) provided LMP Product Management Office an erroneous functional requirement.

Army General Fund (AGF) activities inappropriately expensed \$85 million in GFM transactions during FY 2014 that originated in LMP. This occurred because Army inappropriately used the purchase method when it accounted for GFM.

Additionally, LMP's Management Control Activity (MCA) table did not contain complete and accurate data necessary to maintain visibility or meet reporting requirements of GFM. This occurred because Army did not build the business process functionality or provide sufficient oversight to ensure the reasonableness and quality of data entered into the LMP MCA table met financial reporting requirements.

Finding (cont'd)

As a result, Army did not report GFM in the AGF and AWCF financial statements, understating Army assets and overstating expense accounts by at least \$125.2 million, placing Army's audit readiness at an increased risk for not meeting FY 2017 auditability goals. In addition, without proper accountability records to maintain adequate control over GFM, the Army must rely on individual contractors to report the status of GFM in their respective reporting systems.

Recommendations

We recommend that the ASA(FM&C):

- create a subaccount within LMP to track receipt, acceptance, and consumption of GFM within an Inventory, Work-In-Process account.
- expedite efforts to transition to the consumption method of accounting for GFM.

We recommend that the Deputy Chief of Staff of the Army, G-4, and the ASA(FM&C), in collaboration with Commander, AMC, develop a business process to identify and track GFM within LMP, according to reporting requirements in the DoD Manual 4140.01 and DoD Financial Management Regulation.

We recommend that the Commander, AMC:

- develop oversight procedures to ensure MCAs are consistently and accurately processing GFM.
- in coordination with its Life Cycle Management Commands, validate and quarterly perform reasonableness checks on data in LMP MCA table.

Management Comments and Our Response

Comments from the Army addressed all specifics of the recommendations, and no further comments are required. Please see the Recommendations Table on the back of this page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Deputy Chief of Staff of the Army, G-4		3
Assistant Secretary of the Army (Financial Management and Comptroller)		1, 2, 3
Commander, Army Materiel Command		4, 5



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500**

May 21, 2015

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF
FINANCIAL OFFICER, DOD
DEPUTY CHIEF MANAGEMENT OFFICER
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Army Needs to Improve Processes Over Government-Furnished Material
Inventory Actions (Report No. DODIG-2015-128)

We are providing this report for your information and use. In FY 2014, Army inappropriately expensed about \$125.2 million in Government-furnished material, preventing proper recording and accountability records in the general ledger accounts. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments on a draft of this report when preparing the final report. Comments from the Deputy Assistant Secretary of the Army (Financial Operations), responding for and on behalf of the Deputy Chief of Staff of the Army, G-4, and the Assistant Secretary of the Army (Financial Management and Comptroller), and from the Commander, Army Materiel Command, conformed to the requirements of DoD Instruction 7650.03; therefore, we do not require additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 601-5945 (DSN 329-5945).

A handwritten signature in cursive script that reads "Lorin T. Venable".

Lorin T. Venable, CPA
Assistant Inspector General
Financial Management and Reporting

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Acronyms and Abbreviations

Introduction

Objective

We determined whether the Logistics Modernization Program (LMP) system correctly recorded Army inventory actions for Government-furnished material (GFM) in the general ledger accounts and accountability records. We only addressed GFM Class V¹ and Class IX² transactions³ in this report. See Appendix A for a discussion of the scope and methodology and Appendix B for prior audit coverage.

Background

LMP is an enterprise resource planning system used to record Army logistical and financial transactions. LMP records inventory transactions within the AWCF general ledger and interfaces inventory sales with the AGF through the General Fund Enterprise Business System. The Assistant Secretary of the Army (Financial Management and Comptroller) (ASA[FM&C]) and the Army Materiel Command (AMC) reported to Congress that LMP would be the system solution to develop auditable AWCF financial statements.

ASA(FM&C) plans to develop LMP in two increments:

- **Increment 1.** LMP deployment effort through December 28, 2011, as designated by the milestone decision authority.
- **Increment 2.** LMP acquisition activities after December 2011, as designed by the Defense Business Council.

The Army will implement Increment 2 in a series of three waves⁴ to add functionality. Limited fielding of LMP Increment 2, Wave 2, functionality was approved on July 24, 2014. The life-cycle cost estimate for LMP was \$4.1 billion. As of September 30, 2014, the Army spent approximately \$2.1 billion of the \$4.1 billion to implement the functionality required for LMP.

¹ Class V includes ammunition of all types, bombs, explosives, mines, fuses, detonators, pyrotechnics, missiles, rockets, propellants, and other associated items.

² Class IX includes repair parts and components to include kits, assemblies and subassemblies, reparable and consumable items required for maintenance support of all equipment.

³ The Class IX GFM transactions would normally be accounted for in the "Inventory, Work-In-Process" account (General Ledger Account Code [GLAC] 152600) for Army Working Capital Fund (AWCF) and "Operating Materials and Supplies Held for Use" account (GLAC 151100) or "Construction-in-Progress" account (GLAC 172000) for Army General Fund (AGF).

⁴ Wave 1 is designated for enterprise resource planning integration and reengineering. Wave 2 is designated for enterprise resource planning integration and reengineering not performed in Wave 1, along with functionality associated with Non-Army Managed Items and Army Prepositioned Stock. Wave 3 is designated for National Maintenance Program, Ammunition, and Expanded Industrial Base.

This is the fourth in a series of DoD Inspector General (DoD IG) reports on LMP functionality. Specifically, the:

- first report⁵ concluded that the Army failed to deliver a U.S. Standard General Ledger compliant system;
- second report⁶ concluded that Army did not identify the system requirements for the Procure-to-Pay business process needed to correct the root causes of material weaknesses. In addition, Army managers did not review control activities to assess internal control effectiveness, resulting in the use of costly manual business processes and LMP's failure to provide reliable financial data; and
- third report⁷ concluded that Army financial managers did not provide the correct system configuration requirements for LMP to prepare the Statement of Budgetary Resources and other budgetary reports.

The Army has initiated corrective actions to address most of the issues in prior audit reports. Additional corrective actions are planned.

Government-Furnished Material

When it is in the best interest of the U.S. Government (due to economy, standardization, or to expedite production), material may be provided to a contractor at the expense of the Government as GFM. Material does not include equipment, special tooling, special test equipment or real property. According to the DoD Financial Management Regulation⁸ (FMR), GFM is a sub-category of Government-furnished property, consisting of inventory or operating materials and supplies furnished to a contractor as Government property. The Federal Acquisition Regulation⁹ defines material as property that may be consumed or expended during the performance of a contract, component parts of a higher assembly, or items that lose their individual identity through incorporation into an end item.

Subassemblies and components can be provided by the government to support contract execution. An example of GFM is an engine that is provided to a contractor to use in assembling an aircraft. Government property

⁵ DoD IG Report No. D-2011-015, "Insufficient Governance Over Logistics Modernization Program System Development," November 2, 2010.

⁶ DoD IG Report No. DODIG-2012-087, "Logistics Modernization Program System Procure-to-Pay Process Did Not Correct Material Weaknesses," May 29, 2012.

⁷ DoD IG Report No. DODIG-2014-066, "Logistics Modernization Program System Not Configured to Support Statement of Budgetary Resources," May 5, 2014.

⁸ DoD Financial Management Regulation 7000.14-R (DoD FMR), volume 4, chapter 4, "Inventory and Related Property," May 2009.

⁹ Federal Acquisition Regulation, Part 45, "Government Property," April 2, 2012.

refers to all property owned or leased by the Government,¹⁰ which includes Government-furnished and contractor-acquired property. In compliance with DoD-Manual 4140.01,¹¹ the Army established Management Control Activities (MCAs) to maintain central control and visibility over all Government material provided to a contractor as GFM from the DoD supply system. MCAs validate and approve all contractor-initiated requisitions and DoD-initiated material requisitions that are coded for direct shipment to a contractor. MCA procedures are applicable to material requisitioned for shipment to a contractor on either a reimbursable or nonreimbursable basis as specified in the contract. See Appendix C for additional information on the Army's MCA process.

Army Regulation (AR) 725-50¹² establishes Army GFM policies and procedures for contracting officers, item managers, authorized contractors, and Services/Agencies to obtain Government material for consumption in support of contract requirements. AR 725-50 requires that the MCA provide a management reporting system that maintains GFM status by active contract, requisition, and shipment. MCAs are required to use this information to provide DoD contract administration offices with GFM status reports on a quarterly basis showing shipments of material to contractors, receipts, and contractor requisitions rejected.

Roles and Responsibilities

AWCF's mission is to:

- maintain the Army's combat readiness by providing supplies, equipment, and ordnance to prepare, sustain, and reset Army forces efficiently and cost effectively; and
- control and minimize costs.

The Army offices that manage Army financial management systems and logistical functions are listed below with their key roles and responsibilities related to the audit.

ASA(FM&C)

- modernizes Army financial management systems and processes; and
- integrates financial data and cost information.

¹⁰ A DoD Working Group was established to address various issues with GFM, including its definition. DoD Working Group representatives stated that if the Army uses a contractor to manage/store materials in a Contractor-Owned Contractor-Operated arrangement, then that material would qualify as GFM.

¹¹ DoD Manual 4140.01, "DoD Supply Chain Material Management Procedures," February 10, 2014.

¹² Army Regulation 725-50, "Requisitioning, Receipt, and Issue System," November 15, 1995.

The Army Program Executive Office Enterprise Information Systems

- oversees acquisition, development, and business integration of LMP, which includes oversight of the LMP Product Management Office (PMO).

AMC

- manages logistical and financial functions at AWCF Life Cycle Management Commands (LCMCs).¹³ MCAs are collocated at each of the four LCMCs. The MCAs batch upload GFM requisitions for validation and shipment based on information provided to them from Contracting Offices and Program Management Offices.

The Assistant Secretary of the Army (Acquisition, Logistics, and Technology)

- maintains material readiness through the integration of logistics supportability throughout the acquisition life cycle management process;
- provides oversight of material systems to include acquisition logistics; and
- with the Deputy Chief of Staff of the Army, G-4 (Army G-4), is responsible for Army policy, programming, and oversight of the Army supply system to include GFM within LMP.

For more information on roles and responsibilities, please see Appendix D.

Review of Internal Controls

DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses in the recording of GFM in LMP financial and accountability records. Specifically, the Army inappropriately expensed GFM and the LMP MCA table did not contain complete and accurate data necessary to maintain visibility and meet reporting requirements for property accountability of GFM in support of commercial contract requirements. We will provide a copy of the report to the senior official responsible for internal controls in the Department of the Army.

¹³ The LCMCs under AMC are Aviation and Missile LCMC, Joint Munitions and Lethality LCMC, U.S. Army Communications-Electronics Command, and U.S. Army Tank–Automotive Command.

Finding

Army Did Not Correctly Record Government-Furnished Material

The Army did not correctly record inventory actions for GFM in Army financial and accountability records. Specifically:

- In FY 2014, AWCF activities inappropriately expensed within LMP \$40.2 million in GFM upon shipment to contractors that prevented GFM from being recorded in the proper general ledger accounts. This occurred because ASA(FM&C) and AMC required the LMP PMO to develop LMP with functional requirements that did not comply with the DoD FMR, which resulted in the expensing of GFM upon shipment to contractors.
- AGF activities inappropriately expensed \$85 million in GFM transactions during FY 2014 that originated in LMP. This occurred because Army inappropriately used the purchase method¹⁴ when it accounted for GFM.
- LMP's MCA table did not contain complete and accurate data necessary to maintain visibility and meet reporting requirements for property accountability of GFM in support of commercial contract requirements. This occurred because the Army did not build the business process functionality or provide sufficient oversight to ensure the reasonableness and quality of data entered into the LMP MCA table.

As a result, Army did not report GFM in the AGF and AWCF financial statements, understating Army assets and overstating expense accounts by at least \$125.2 million, placing Army's audit readiness at an increased risk for not meeting FY 2017 auditability goals. In addition, without proper accountability records to maintain adequate control over GFM, the Army must rely on individual contractors to report the status of GFM in their respective reporting systems.

¹⁴ The purchase method of accounting provides that Operating Materials and Supplies (OM&S) are expensed when purchased.

Army Inappropriately Expensed GFM

In FY 2014, Army LCMCs expensed approximately \$125.2 million in GFM and did not account for Army GFM transactions in the proper asset general ledger accounts. Table 1 shows the dollar values of AWCF GFM transactions and AWCF sales of GFM to AGF that were inappropriately expensed in FY 2014.

Table 1. GFM Sales Inappropriately Expensed in FY 2014

GFM Category	Cost (In millions)
AWCF Materials	\$40.2
AGF Materials	\$67.4
AGF Ammunition	\$17.6
Total GFM	\$125.2

Army understated its assets and overstated expense accounts by at least \$125.2 million¹⁵ during FY 2014 because the Army expensed AWCF GFM upon shipment to contractors¹⁶ and expensed AGF GFM upon purchase from the AWCF. Army considered AWCF inventory items purchased by AGF as OM&S. AGF uses the purchase method of accounting for OM&S and expenses the items when purchased from AWCF.

AWCF GFM Expensed to Loss Account

Of the \$125.2 million, the Army improperly expensed \$40.2 million in AWCF GFM transactions to GLAC 729000, "Other Losses," instead of capitalizing the cost of GFM and recording transactions in the proper "Inventory, Work-in-Process" account.

The Army improperly expensed \$40.2 million in AWCF GFM transactions to GLAC 729000, "Other Losses."

This practice was not compliant with generally accepted accounting principles, specifically the matching principle.¹⁷

According to the DoD FMR,¹⁸ the Army is required to maintain a subsidiary account, subdivided by contract, for "Inventory, Work-in-Process" for each contractor that is provided GFM for use in performance of a contract and that is

¹⁵ Specifically, the Army did not track the amount of GFM consumed by contractors and could not provide the actual balance of AWCF and AGF GFM as of September 30, 2014. The \$125.2 million in AWCF GFM transactions and AWCF sales of GFM to AGF occurring in FY 2014 would not reflect prior-year GFM on-hand balances. Additionally, the \$125.2 million in AWCF and AGF GFM transactions did not cover GFM that the contractor has custody of and is accounted for in the "Inventory, Held for Sale" account (GLAC 152100) and "Inventory, Held for Repair" account (GLAC 152300).

¹⁶ The \$40.2 million in understated AWCF inventory is an estimate based on GFM transactions that would normally be accounted for in the "Inventory, Work-in-Process" account (GLAC 152600) in FY 2014.

¹⁷ The matching principle requires matching of expenses incurred over the course of normal business with revenue received to measure the net income of a business entity.

¹⁸ DoD FMR, volume 4, chapter 4, "Inventory and Related Property," May 2009.

to be returned upon completion of the contract. A work-in-process account consists of the costs of direct materials, direct labor, direct purchased services, and indirect costs, including general and administrative cost, used in producing or repairing an end item, whether fabricated by DoD or by a non-DoD organization under contract. Work-in-process accounts bring costs under financial control and segregate them from current accounting period expenses. In the FY 2014 AWCF trial balance, zero dollars was reported in GLAC 152600, "Inventory, Work-in-Process."

The DoD FMR¹⁹ also states that the "Other Losses" account is for recording the loss on assets that result from events other than disposition. DoD normally uses this account to record a contingent liability, loss of inventory, and foreign currency.

Periodically, but at least annually, the Army must reconcile these accounts with the property accountability records maintained by the contractor. Although LMP recorded shipments to contractors, it did not record them in the MCA table. Additionally, LMP did not have the functionality to track GFM receipt, acceptance, and consumption by contract.

Army Managers Provided Erroneous Functional Requirements

ASA(FM&C) and AMC required the LMP PMO to develop LMP with functional requirements that did not comply with the DoD FMR, which resulted in the expensing of GFM upon shipment to contractors. Before LMP was implemented, the Army tracked GFM in an "Inventory, Work-in-Process" subaccount and tracked receipt, acceptance, and consumption by contract in the Commodity Command Standard System. However, the Army did not establish this functionality in LMP. Just before the Army began to develop LMP, a report²⁰ from the U.S. Army Audit Agency identified that the Office of the Secretary of Defense (Comptroller)/Chief Financial Officer proposed a change to the DoD FMR. This change would have required AWCF to expense materials when issued to a contractor for consumption or incorporation into an end item rather than develop the functionality to create subsidiary accounts to record GFM transactions using GLAC 152600. However, this change was not incorporated into the DoD FMR.

Army personnel stated that they assumed the policy change would be made, and the LMP PMO programmed the system to expense GFM upon shipment to a contractor. As a result, the LMP PMO did not build into LMP the appropriate transaction posting logic required by generally accepted accounting principles and the DoD FMR for processing AWCF GFM transactions. ASA(FM&C) should create a subaccount within LMP to track receipt, acceptance, and consumption of GFM within an Inventory, Work-in-Process account.

¹⁹ DoD FMR, volume 4, chapter 16, "Revenue, Other Financing Sources, Gains and Losses," March 2012.

²⁰ U.S. Army Audit Agency Audit Report Number: AA 98-259, "Army Working Capital Fund FY 97 Financial Statements, Inventory-Government-Furnished Material," June 30, 1998.

GFM Expensed as Operating Materials and Supplies

The Army inappropriately expensed \$85 million in AWCF sales to AGF for GFM (materials and ammunition). In addition to GFM that LCMCs provided to contractors on AWCF contracts, some AGF contracts required inventory be bought from AWCF that was provided to contractors as GFM. AGF was required to reimburse the AWCF for the exchange of materials between a nonappropriated fund account and an appropriated fund account.

AWCF properly expensed AGF material and ammunition sales orders in LMP to GLAC 650000, "Cost of Goods Sold." However, AGF used the purchase method for these sales and expensed the GFM transactions as OM&S immediately upon the sale from AWCF to AGF. Statement of Federal Financial Accounting Standards 3 (SFFAS 3) defines OM&S as consisting of tangible personal property to be consumed in normal operations. Exclusions from this definition include goods that have been acquired for use in constructing real property or in assembling equipment to be used by the entity. Many AWCF items purchased by AGF were items going into assembling general equipment, including upgrades to existing equipment.

For example, contract W58RGZ-12-C-0008 is for the production or assembly of the UH60M Black Hawk helicopter. Total AWCF sales to the AGF during FY 2014 on this contract to provide GFM totaled \$43.2 million. The \$43.2 million in GFM was expensed upon purchase from AWCF by AGF. The Army typically classifies general equipment under construction as "Construction-in-Progress" (GLAC 172000). However, GFM expensed was not included in "Construction-in-Progress" and the valuation of the equipment may not be proper as a result.

The Army's use of the purchase method of accounting is a material weakness²¹ for the Army and DoD. Consequently, the Army could not quantify AGF GFM. Note 9, in the AGF FYs 2013 and 2014 Army Financial Statements, stated:

The values of the Army's government-furnished material and contractor-acquired material in the hands of the contractors are normally not included in the OM&S values reported above. The DoD is presently reviewing its process for reporting these amounts in an effort to determine the appropriate accounting treatment and the best method to collect and report required information annually without duplicating information in other existing logistics systems.

The Army's use of the purchase method of accounting is a material weakness for the Army and DoD.

²¹ Fiscal Year 2014 United States Army Annual Financial Report, Note 1.M, "Inventories and Related Property," of the Army General Fund Financial Statements describes use of purchase method as a material weakness for the Army and DoD.

The Army had similar language in its financial statements since FY 2002 related to GFM. Based on our suggestion during the audit, similar language was added in Note 9 of the AWCF FY 2014 Financial Statements. The Army should ensure that all GFM transactions are recorded in asset accounts rather than expense accounts so that assets are not understated on AWCF and AGF balance sheets.

Army's Use of the Purchase Method Was Inappropriate

AGF inappropriately used the purchase method of accounting for AWCF sales to the AGF for purpose of providing GFM to contractors. The Army's use of the purchase method of accounting was contrary to SFFAS 3, which required the consumption method.²² In AGF financial statements for FY 2014, Note 1.M, Army states, "The Army General Fund expensed significant amounts using the purchase method because systems could not support the consumption method or management deemed that the item was in the hands of the end user." In addition, Note 1.F states, "Efforts are underway to transition to the consumption method for recognizing OM&S expenses."

AGF use of the purchase method of accounting also inhibited GFM items purchased from AWCF to be capitalized in a major repair, upgrade, or modification when consumed. For example, national item identification number²³ (NIIN) 01-466-3753 is a vehicular power transmission component valued at more than \$216,505 each. These components were provided as GFM to an AGF activity contractor. However, the Army expensed this component based on its use of the purchase method of accounting. ASA(FM&C) should expedite efforts to transition to the consumption method of accounting for GFM, unless it can document a strong business case for using the purchase method to recognize OM&S expenses. In developing this business case, ASA(FM&C) needs to consider the capitalization effect of GFM items included for upgrades, modifications, or assembly of end items, to include general equipment.

²² Statement of Federal Financial Accounting Standards No. 3: Accounting for Inventory and Related Property, dated October 27, 1993, states "the consumption method of accounting for recognition of expenses shall be applied for operating materials and supplies. Operating Materials and Supplies shall be recognized and reported as assets when produced or purchased."

²³ NIIN is the last 9 digits of the national stock number that differentiates each individual supply item from all other supply items. The first 2 digits signify the National Codification Bureau that assigns the NIIN, while the last 7 digits are not significant and are sequentially assigned by the Federal Logistics Information System. All U.S. manufactured items have a National Codification Bureau Code of "00" (cataloged before 1975) or "01" (cataloged in 1975 or later).

LMP Could Not Maintain Visibility Over GFM

The LMP MCA table did not contain complete and accurate data necessary to maintain visibility and meet reporting requirements for property accountability of GFM in support of commercial contract requirements. The Army placed the contractor in charge of managing GFM under the terms of a contract. Contractors were required to account and report to the Army GFM that was received until consumed through the incorporation in a new or repaired end item.

However, the Army was required to maintain accurate on-hand balances of GFM. It was also required through the MCA process to identify and record GFM authorized, requisitioned, shipped, received, and consumed. Similar information must also be reflected in the Army's Accountable Property Systems of Record. The Accountable Property System of Record is a subsidiary ledger to the financial system's general ledger and represents the transactions impacting the property, which as defined by the Federal Acquisition Regulation²⁴ includes material. To become auditable, Army officials must align their Accountable Property System of Records with their core financial systems for both AWCF and AGF.

Incomplete Data in LMP MCA Table

The Army did not develop the LMP MCA table to record data on GFM shipments to contractors or the GFM receipt, acceptance, and consumption data needed to generate property accountability records and maintain proper control and visibility over GFM in the custody of contractors.

One of the primary functions of the MCA process is to establish a management reporting system to complete the GFM status report. DoD Manual 4140.01, volume 9, requires MCAs to provide a GFM status report to DoD contract administration offices on a quarterly basis. The Army used the Defense Contract Management Agency for contract administration services. The GFM status report should reflect by contract, a requisition and shipment status history that served as an auditable record of transactions involving DoD material provided to contractors.

LMP could not generate required GFM status reports needed to maintain visibility over accountable property. Defense Contract Management Agency personnel confirmed they relied upon contractor records to perform their inventory reviews rather than reports generated from LMP.



LMP could not generate required GFM status reports needed to maintain visibility over accountable property.

²⁴ Federal Acquisition Regulation Part 45, defines property as all tangible property, both real and personal. Federal Acquisition Regulation states material is property. Federal Acquisition Regulation also states that government property is all property owned by the Government, including Government-furnished property.

Data Quality in MCA Table Needs Improvement

The MCA table also contained inaccurate data. AR 725-50 states that the MCA is responsible for overall control and visibility of all Army GFM. Each of the four Army LCMCs designated a MCA to oversee the issuance of GFM placed on contract. For each contract, the responsible MCA uploaded GFM information, including authorized quantities, in the MCA table that resided in LMP. Typically, the authorized quantities of GFM were identified in contract attachments.

AR 725-50 also prescribes guidelines for authorized contractors and Services/Agencies to requisition GFM and for MCAs to validate requisitions in support of contract requirements. MCA personnel used the LMP MCA table to validate GFM requisitions and issue shipments by contract. However, significant differences in quantities existed in the MCA table as of June 5, 2014. For example:

- **Contract Number W31P4Q-11-C-0087.** This contract is for depot-level maintenance of the HELLFIRE family of missiles and components.
 - Authorized quantities within the MCA table for all NIINs were at least triple the amounts allowed on the associated contract.
 - GFM contract attachment indicated that the contractor was only authorized a quantity of 301 “Launch Shoe Guide,” NIIN 01-1268593. However, the MCA table indicated a quantity of 903.
 - On a different NIIN, the MCA table showed an authorized quantity of 330 (wing missiles) while the contract authorized only 110.
 - In total, MCA overstated authorized amounts in the MCA table by a total amount of at least \$503.5 million for the 111 NIINs for this contract.
- **Contract Number W58RGZ-13-C-0028.** A performance-based lifecycle contract for the Fire Control Radar System on AH-64D Apache helicopters.
 - MCA table overstated authorized amounts for 122 NIINs.
 - MCA table showed a quantity of 300 authorized, totaling \$22.7 million, for NIIN 01-4137780, “Electronic Component,” while the GFM contract attachments showed 26 authorized, totaling \$2 million. The quantity entered of 300 was an information field from the contract attachment called the movement code, which was not the authorized quantity.
 - MCA table overstated the authorized amount by \$20.7 million.

Overstated quantities in the MCA table could have resulted in the contractor being shipped or requisitioning more GFM than authorized by the contracts. The MCA table indicated that ordered quantities were less than the authorized quantities on the contract.

The MCA table also contained contracts where Government property furnished to the contractor was Government-furnished equipment, not GFM. For example, contract number W56HZV-09-D-0024 was for retrograding equipment, which was furnished to the contractor. U.S. Army Tank–Automotive Command did not specify in the contract a quantity of retrograde equipment to be repaired and entered an incorrect large quantity in the MCA table. Instead of entering the quantity of retrograde equipment, the NIIN (01-523-1142) was entered as the authorized quantity resulting in the significant overstatement of authorized dollars. The LMP MCA table was not intended to account for Government-furnished equipment.

LMP Lacks Functionality to Oversee Army GFM

LMP did not have the business process functionality or data to allow proper oversight of Army GFM and meet financial reporting requirements. ASA(FM&C) and AMC personnel did not require the LMP PMO to develop the proper data interfaces and reporting functionality to meet requirements identified in DoD Manual 4140.01, volume 9, and the DoD FMR.

In addition, DoD Instruction 5000.64²⁵ requires that accountability of property be established upon receipt, delivery, or acceptance and maintained in the Accountable Property System of Record. Although the Army may not have physical custody, to maintain effective property accountability and for financial reporting purposes, it is required to establish and maintain records and accountability for all property furnished to contractors as GFM.

Needed Business Process Functionality Did Not Exist

ASA(FM&C) and AMC did not integrate the accountability reporting into LMP that identified what GFM contractors had on hand and when GFM was consumed by contractor or otherwise returned to the Army. The Under Secretary of Defense (Acquisition, Technology, and Logistics) issued a memorandum in January 2010 that emphasizes strong internal controls and oversight practices with the DoD Item Unique Identification Standards Registry and its Government-furnished property module as the cornerstone of Government-furnished property reporting.

²⁵ DoD Instruction 5000.64, "Defense Property Accountability," May 19, 2011.

The Army is developing a system change request for LMP to interface with the DoD Item Unique Identification Standards Registry. Once implemented in May 2015, LMP PMO personnel stated that information from contractors possessing GFM can be better tracked and accounted for. As part of this initiative, Army G-4 and the ASA(FM&C), in collaboration with the Commander, AMC, should develop a business process and the LMP posting logic to identify and track GFM within LMP. Specifically, the Army should use LMP to report AWCF inventory provided to contractors as GFM to meet GFM reporting requirements in DoD Manual 4140.01, volume 9, and DoD FMR, volume 4, chapter 4.

AMC Lacked Oversight of Management Control Activity

AMC did not provide sufficient oversight of the MCA personnel located at the Army LCMCs to ensure the reasonableness and quality of data entered into the LMP MCA table. Although MCA personnel at each Army LCMC had standard operating procedures, AMC personnel acknowledged that they did not standardize the MCA process or review the information in the MCA table to ensure its reliability.

The National Institute of Standards and Technology Special Publication 800-53²⁶ states that federal entities should implement procedures to reasonably assure that data input into an information system is complete, accurate, and valid and any incorrect information is identified, rejected, and corrected for subsequent processing. The Commander, AMC, should develop oversight procedures to ensure that MCAs consistently and accurately process GFM. The Commander, AMC, in coordination with each LCMC, should validate and quarterly perform reasonableness checks on data in the LMP MCA table.

Army Did Not Record GFM in Financial Statements

As a result, Army did not report GFM in the AGF and AWCF financial statements, understating Army assets and overstating expense accounts by at least \$125.2 million, placing Army's audit readiness at an increased risk for not meeting FY 2017 auditability goals. Because LMP expensed GFM from inventory at the time of shipment, the Army could not trace GFM in AWCF inventory. Additionally, the Army did not have a reporting mechanism to track receipt and consumption of GFM required for quarterly reports to



Army did not report GFM in the AGF and AWCF financial statements, understating Army assets and overstating expense accounts.

²⁶ The National Institute of Standards and Technology Special Publication 800-53, "Security and Privacy Controls for Federal Information Systems and Organizations," Section SI-10, January 15, 2014.

contract administration offices. Without Government accountability records to maintain adequate control over GFM, DoD contract administration office personnel relied on contractor records to perform their inventory reviews. The financial system of record and the Accountable Property System of Record should reconcile. This increased the risk of fraud, waste, and abuse to the Army's inventory by its contractors.

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) create a subaccount within the Logistics Modernization Program system to track receipt, acceptance, and consumption of Government-furnished material within an "Inventory, Work-in-Process" account.

Assistant Secretary of the Army (Financial Management and Comptroller) Comments

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), partially agreed, stating that not all GFM should be recorded in an "Inventory, Work-in-Process" account. The Deputy Assistant Secretary stated that GFM will be recorded in an "Inventory, Held for Sale" account until the contractor issues it for consumption in a repair or production order, and then the GFM will be recorded in an "Inventory, Work-in-Process" account until the Government accepts the finished item. The Deputy Assistant Secretary also stated that the ASA(FM&C) will create a plan of action and milestones to track receipt, acceptance, and consumption of GFM, by December 31, 2015.

Our Response

Although the Deputy Assistant Secretary partially agreed with the recommendation, the comments and plan of action meet the intent of the recommendation. We agree that GFM should be recorded in an "Inventory, Held for Sale" account until the contractor issues it for consumption in a repair or production order. No further comments are required.

Recommendation 2

We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) expedite efforts to transition to the consumption method of accounting for Government-furnished material, unless it can document a strong business case for using the purchase method to recognize operating materials and supplies expenses. In developing this business case, consider the capitalization effect of Government-furnished material items included for upgrades, modifications, or assembly of end items, to include general equipment.

Assistant Secretary of the Army (Financial Management and Comptroller) Comments

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), agreed and will research and analyze the specific scenarios where LMP is recording the logistics transactions for OM&S furnished to contractors as GFM. The Deputy Assistant Secretary stated that ASA(FM&C) will also consider the capitalization effect of the GFM items and coordinate with the Office of the Under Secretary of Defense (Comptroller) Financial Improvement and Audit Readiness Directorate to determine the proper accounting treatment for this material. If no exceptions to use the consumption method are found, then ASA(FM&C) will develop a plan of actions and milestones to transition to the consumption method of accounting by September 30, 2016.

Our Response

The Deputy Assistant Secretary addressed all specifics of the recommendation, and no additional comments are needed. ASA(FM&C) will need to ensure that it documents the strong business case, if in its research and analysis, ASA(FM&C) determines that the purchase method is the best and appropriate way forward.

Recommendation 3

We recommend that the Deputy Chief of Staff of the Army, G-4, and the Assistant Secretary of the Army (Financial Management and Comptroller), in collaboration with the Commander, Army Materiel Command, develop a business process and the Logistics Modernization Program posting logic to identify and track Army Working Capital Fund inventory provided to contractors as Government-furnished material within the Logistics Modernization Program system. Specifically, the Army should use the Logistics Modernization Program system to report Army Working Capital Fund inventory provided to contractors as Government-furnished material to meet requirements in the DoD Manual 4140.01, volume 9, and DoD 7000.14-R, DoD Financial Management Regulation, volume 4, chapter 4.

Department of the Army Comments

The Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), agreed, stating that in December 2014, AMC completed a change requirements document for business process re-engineering of the MCA/GFM solution in LMP. The modernized solution will provide visibility of all orders submitted to or generated by the government supply system for GFM and provide visibility of GFM by recording shipments, material receipt acknowledgements, and consumption, and by capturing and maintaining historical data by contract for reporting purposes. The Deputy Assistant Secretary also stated that Army G-4 and the ASA(FM&C), in coordination with AMC, will take the necessary actions leading up to an Army decision on proceeding with development. These actions will be completed by March 31, 2016.

Our Response

The Deputy Assistant Secretary addressed all specifics of the recommendation, and no further comments are required. Ultimately, AMC's decision to approve the change requirements document will determine whether Army addresses the intent of this recommendation. If the change requirements document is not implemented, then AMC will have to rely on the manual procedures detailed in AMC's policy memorandum, dated April 6, 2015 (Recommendation 4.), for reviewing and approving GFM requisitions and reporting GFM transactions to higher headquarters until an automated solution can be fielded.

Recommendation 4

We recommend that the Commander, Army Materiel Command, develop oversight procedures to ensure that Management Control Activities consistently and accurately process Government-furnished material.

Commander, Army Materiel Command Comments

The Commander, AMC, agreed, stating that it issued a policy memorandum on April 6, 2015, to subordinate LCMCs that established actions necessary to ensure MCAs are consistently and accurately processing GFM and performing reasonableness checks on data in LMP MCA tables.

Our Response

The Commander addressed all specifics of the recommendation, and no further comments are needed.

Recommendation 5

We recommend that the Commander, Army Materiel Command, in coordination with each Life Cycle Management Command, validate data in the Logistics Modernization Program Management Control Activity table and perform reasonableness checks quarterly.

Commander, Army Materiel Command Comments

The Commander, AMC, agreed, stating that the AMC policy memorandum dated and issued on April 6, 2015, addresses reasonableness checks, updating of accountable records, and annual inspections by Headquarters, AMC. The Commander also stated that LMP system enhancements, as defined in the change requirements document, will allow for better oversight of GFM by contract until consumed or returned to the Government at contract termination and enable the Government to better monitor “fraud, waste, and abuse.”

Our Response

The Commander addressed all specifics of the recommendation, and no further comments are needed.

Unsolicited Comments

Commander, Army Materiel Command Comments

Although not required to comment, the Commander, AMC, agreed with Recommendation 3. and provided similar comments as the Deputy Assistant Secretary of the Army (Financial Operations).

Assistant Secretary of the Army (Financial Management and Comptroller) Comments

Although not required to comment, the Deputy Assistant Secretary of the Army (Financial Operations), responding for the ASA(FM&C), agreed with Recommendations 4. and 5. and provided an identical response as the Commander, AMC.

Our Response

We acknowledge the comments from the Deputy Assistant Secretary and Commander and have included them in the final copy of this report.

Appendix A

Scope and Methodology

We conducted this audit from March 2014 through April 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

We reviewed the following guidance to understand how the LMP system should have recorded Army inventory actions for GFM in the general ledger accounts and accountability records.

- Federal Acquisition Regulation Part 45, “Government Property,” Subpart 45-101, “Definitions”
- DoD Manual 4140.01
- DoD FMR 7000.14
- DLM 4000.25, volume 1, “Defense Logistics Management System Concepts and Procedures,” May 19, 2014
- AR 735-5

We focused our audit on the Army GFM provided to contractors that was controlled by the MCA process, specifically Class V and Class IX material. We reviewed standard operating procedures from Army LCMCs on the MCA processes and received detailed briefings from LMP PMO to understand how LMP PMO implemented the DoD Business Enterprise Architecture’s Plan-to-Stock business processes supporting GFM.

We held detailed discussions with personnel from the offices of the:

- Under Secretary of Defense(Comptroller)/Chief Financial Officer, DoD;
- Deputy Chief Management Officer;
- ASA(FM&C);
- Assistant Secretary of the Army (Acquisition, Technology and Logistics);
- Aviation and Missile Command;
- Army G-4; and
- LMP PMO.

We conducted site visits to Aviation and Missile Command, located in Huntsville, Alabama, and LMP PMO, located in Marlton, New Jersey. In addition, we obtained business process flow charts, documentation, and system change requests related to managing GFM in LMP.

LMP PMO provided data extracts of the MCA and purchase order tables as of June 5, 2014. We used the MCA table to select six contracts that contained activity dated after January 1, 2014. We then downloaded documents related to these contracts from the Electronic Document Access system. We compared the Electronic Document Access system contract data to data provided by LMP PMO and data in the LMP MCA, sales order, and purchase order tables to determine if guidance related to GFM was followed. We also received files containing sales order data processed within LMP that shipped GFM during FY2014. This information was used to determine the \$125.2 million in inventory shipped during FY2014 used within the report.

LMP PMO and ASA(FM&C) personnel also provided a detailed walk-through of system data and provided a narrative description and screen prints of GFM business events within the LMP system. AWCF reported \$21 billion in inventory on its balance sheet as of September 30, 2014. AGF reported \$33.2 billion in OM&S on its balance sheet as of September 30, 2014.

Use of Computer-Processed Data

We used computer-processed data extracted from LMP. LMP PMO personnel provided information from the MCA table as well as from the sales orders and purchase orders tables in excel spreadsheets. We obtained contracts, contract modifications, and GFM attachments related to six contracts that we selected from the MCA table. We required LMP PMO and Army representatives to demonstrate GFM processes within LMP based on the selected six contracts by performing screen by screen reviews of system data and creating narratives describing how LMP processes GFM data. The LMP MCA table did not contain complete and accurate data necessary to maintain visibility and meet reporting requirements for property accountability of GFM in support of commercial contract requirements, as stated in the finding. We believe the computer-processed data we used were sufficiently reliable for reaching the audit conclusions and supporting the finding in this report.

Use of Technical Assistance

We did not use technical assistance during the audit.

Appendix B

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO), the Department of Defense Inspector General (DoD IG) and Army Audit Agency issued 14 reports discussing LMP and GFM. Unrestricted GAO reports can be accessed at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>. Unrestricted Army Audit Agency reports can be accessed from .mil and gao.gov domains at <https://www.aaa.army.mil/>.

GAO

Report No. GAO-14-182, “Defense Logistics: Actions Needed to Improve Department-Wide Management of Conventional Ammunition Inventory,” March 2014

Report No. GAO-14-51, “Defense Logistics: Army Should Track Financial Benefits Realized from its Logistics Modernization Program,” November 2013

Report No. GAO-13-557, “DoD Business Systems Modernization: Further Actions Needed to Address Challenges and Improve Accountability,” May 2013

Report No. GAO-12-685, “DoD Business Systems Modernization: Governance Mechanisms for Implementing Management Controls Need to Be Improved,” June 1, 2012

Report No. GAO-12-565R, “DoD Financial Management: Reported Status of Department of Defense’s Enterprise Resource Planning Systems,” March 30, 2012

Report No. GAO-12-177T, “DoD Financial Management: Challenges in the Implementation of Business Systems Could Impact Audit Readiness Efforts,” October 27, 2011

Report No. GAO-11-139, “Defense Logistics: Improved Management Oversight and Reporting for the Army Logistics Modernization Program Are Needed,” November 2010

Report No. GAO-10-461, “Defense Logistics: Actions Needed to Improve Implementation of the Army Logistics Modernization Program,” April 2010

DoD IG

Report No. DODIG-2014-066, "Logistics Modernization Program System Not Configured to Support Statement of Budgetary Resources," May 5, 2014

Report No. DODIG-2013-111, "Status of Enterprise Resource Planning Systems' Cost, Schedule, and Management Actions Taken to Address Prior Recommendations," August 1, 2013

Report No. DODIG-2013-025, "Accountability Was Missing for Government Property Procured on the Army's Services Contract for Logistics Support of Stryker Vehicles," November 30, 2012

Report No. DODIG-2012-087, "Logistics Modernization Program System Procure-to-Pay Process Did Not Correct Material Weaknesses," May 29, 2012

Report No. D-2011-015, "Insufficient Governance Over Logistics Modernization Program System Development," November 2, 2010

Army

Report No. A-2010-0188-ALM, "Depot-Level Maintenance Workload Reporting – FY 09," September 27, 2010

Appendix C

Army GFM Process within LMP

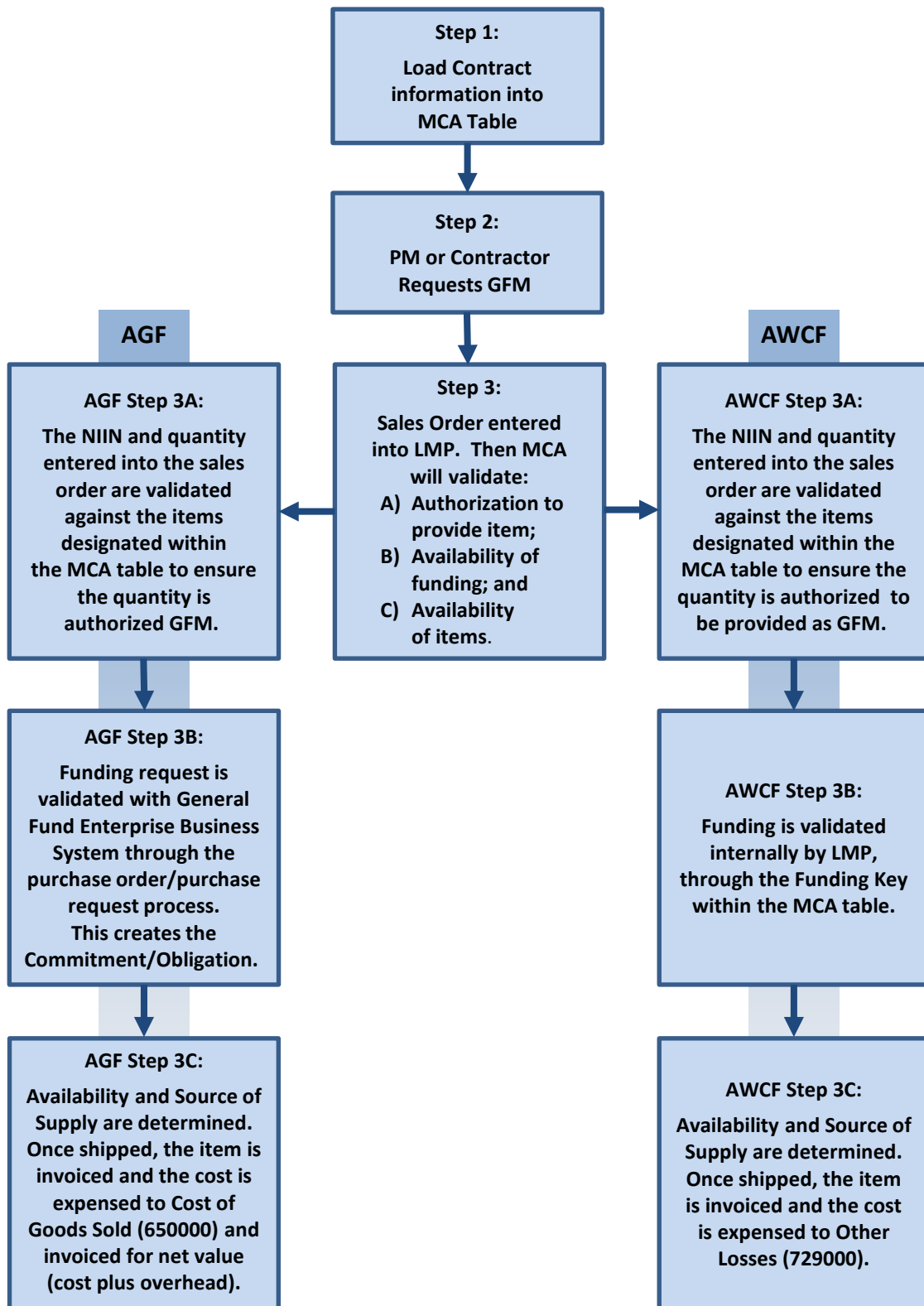
Prior to implementing LMP, the Army used the MCA process that it incorporated into the Commodity Command Standard System to maintain a record of contractor GFM requirements and validate contractor requisitions. By controlling contractor access to AGF and AWCF inventories, fraud, waste, and abuse could then be reduced. The MCA process, including the use of the MCA table, was also designed to establish and record the type of funds used to fund GFM provided to the contractor and, thereby, allowed the recovery of actual GFM costs associated with commercial repair.

In FY 2010, AWCF migrated to LMP as the system of record for AWCF. This included the implementation of the MCA process. Within this process, the MCA table facilitated the tracking and inventory authorizations of GFM items managed by AWCF for both AGF and AWCF contracts. For AWCF, LMP facilitated both the funding authorizations and sales orders for the MCA process. Once shipped, AWCF material was expensed to the GLAC 729000, "Other Losses."

For AGF, the process involved MCA personnel from the LCMCs to manage the OM&S and enter GFM items within the MCA table. This facilitated the process by validating the authorized dollars for the contract through an interface with the General Funds Enterprise Business System. Once authorized, the sales orders were released within LMP and the inventory was allocated to the order and shipped to the contractor. If the item was not in stock, it was added to a purchase requisition and forwarded through the purchasing process. Once shipped to the contractor, the item was expensed from AWCF using the GLAC 650000, "Cost of Goods Sold," and the AGF customer would be billed. Due to the use of the purchase method of accounting, AGF customers expensed GFM items as OM&S upon purchase from AWCF and did not record them in AGF asset accounts.

An exception to this process was the issuance of ammunition as GFM. Due to system gaps, ammunition could not follow the designated process. Ammunition items were manually added to the MCA table; however, unlike materials, ammunition sales orders and shipments were not reflected on the MCA table. Figure 1 provides a flowchart of the GFM process within LMP.

Figure 1. Process Flowchart of Army GFM



Appendix D

GFM Guidance and Related Duties by Functional Component

Functional Component	Guidance	Related Duties
Army/LCMC		
	DoD Instruction 5000.64	<p>Manages all property throughout lifecycle from initial acquisition and receipt, through accountability and custody.</p> <p>Establishes and maintains records for property accountability and financial reporting.</p> <p>Appoints, in writing, Accountable Property Officer to establish and maintain accountable property records for GFM in Army and contractor possession.</p>
	DoD Instruction 4161.02	Requires electronic transactions to transfer Government Property to Contractor.
	DoD Manual 4140.01, volume 9	Establishes at least one MCA to maintain control over all GFM requisitions that indicate shipment to a contractor.
	Army Regulation (AR) 725-50	Approves and tracks all GFM furnished to contractor through the MCA. The MCA will keep central control over and visibility of GFM, including contractor access to the DoD supply system, and identify all material provided to contractors by the Government.
Program Manager		
	Defense Federal Acquisition Regulations (DFARS) Procedures, Guidance, and Information (PGI) 245.103-70 and DoD Government Furnished Property Operating Guide	Determines, initiates, and requests (push) GFM and provides contracting officer with a schedule or requisition list of GFM to be furnished.

GFM Guidance and Related Duties by Functional Component (cont'd)

Functional Component	Guidance	Related Duties
Contracting Officer		
	Federal Acquisition Regulation (FAR) 42.302, and 52-245-1; and AR 735-5	Assigns Property Administrator or Defense Contract Management Agency to oversee GFM in contractor possession and describe general duties.
	DFARS 252.245-7001, DFARS 252.211-7003, DFARS 252.211-7007, and DoD Government Furnished Property Operating Guide	Adds applicable FAR and DFARS contract clauses for GFM.
	DFARS PGI 245.103-71, DFARS PGI 245.103-72, DFARS PGI 245.103-73, DoD Manual 4140.01 and DoD Government Furnished Property Operating Guide	Writes the solicitation and contract with the GFM listed and adds appropriate FAR clauses Determines requisition type (push/pull) and attaches GFM list to the contract. Prepares and maintains GFM attachments to the contract. Reports and records transfer of GFM from one contract to another.
	AR 735-5	Requires contractors to report their on-hand Army property balances.
Property Book Officer		
	DoD Instruction 5000.64	Establishes and maintains accountable property records, systems, and financial records, in connection with Government property.
	AR 735-5	Tracks all Army property to include transfers and conducts joint physical inventory with the contractor.
Contractor Duties		
	DFARS PGI 245.102-70	Steward of Government property.
	DFARS 211.274-4; DFARS 252.211-7007 and DoD Instruction 8320.04	Establishes and maintains Item Unique Identification registry as master data source for Government-furnished property.
	DoD Instruction 4161.02	Uses wide area workflow or Defense Logistics Management System to acknowledge receipt and report usage of GFM.

Management Comments

Assistant Secretary of the Army (Financial Management and Comptroller) Comments



DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
FINANCIAL MANAGEMENT AND COMPTROLLER
109 ARMY PENTAGON
WASHINGTON DC 20310-0109

SAFM-FO


MAY 5 2015

MEMORANDUM FOR Assistant Inspector General for Audit, Department of Defense
Inspector General, 4800 Mark Center Driver, Alexandria, VA 22350-1500

SUBJECT: Response to Army Needs to Improve Processes Over Government-Furnished Material Inventory Actions (Project No. D2014-D000FI-0138.000)

1. This memorandum provides a response to the findings and recommendations for the subject review.
2. The Department of Defense Inspector General (DoDIG) report recommends the Assistant Secretary of the Army (Financial Management and Comptroller) and the Deputy Chief of Staff of the Army, G-4, in collaboration with the Commander, Army Materiel Command, track Government-furnished material (GFM) within an "Inventory, Work-in-Process" account in the Logistics Modernization Program (LMP) and expedite efforts to transition to the consumption method of accounting for GFM. The report also recommends the Commander, Army Materiel Command develop oversight procedures to ensure Management Control Activities consistently and accurately process GFM and validate data in the LMP Management Control Activity table and perform reasonableness checks quarterly.
3. The following responses address the findings and recommendations identified in your report "Army Needs to Improve Processes Over Government-Furnished Material Inventory Actions", dated 3 April 2015. The Army partially concurs with one recommendation and concurs with the other four recommendations.
4. We coordinated this reply with the Deputy Chief of Staff of the Army, G-4, Headquarters, Army Materiel Command, and Program Manager, Army Enterprise Systems Integration Program.
5. The point of contact for this action is [REDACTED], Acting Director, Army Working Capital Fund Audit Readiness. He can be reached by e-mail at [REDACTED] and by telephone at [REDACTED].

Enclosure


Laura M. Jankovich
Deputy Assistant Secretary of the Army
(Financial Operations)

Assistant Secretary of the Army (Financial Management and Comptroller) Comments (cont'd)

Enclosure: Official Comments

DODIG Draft Report D2014-D000FI-0138.000
Army Needs to Improve Processes Over Government-Furnished Material Inventory
Actions, dated 3 April 2015

- a. Recommendation 1: We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) create a subaccount within the Logistics Modernization Program system to track receipt, acceptance, and consumption of Government-furnished material within an "Inventory, Work-in-Process" account.

Response: The Army partially concurs with this recommendation. The scope of this audit included one of three subsets of Army Working Capital Fund (AWCF) Government-furnished material (GFM) which totaled \$40.2 million of AWCF Inventory in Fiscal Year (FY) 2014. In comparison, the Army reported \$21.0 billion of AWCF Inventory on the FY 2014 Annual Financial Report, of which over \$1 billion is GFM. The subset of GFM included in this audit consists of government-owned secondary items in serviceable condition furnished to a contractor with the intent to be incorporated into or attached to a deliverable end-item. This audit eliminated government-owned repairable material in unserviceable condition shipped to a contractor to be repaired. It also eliminated government-owned material where the contractor is serving as an Inventory Control Point performing a warehouse management function (receipt, store, and issue). Both of those categories of GFM are currently included in the AWCF "Inventory Held for Sale" and "Inventory Held for Repair" general ledger accounts.

For the subset of GFM included in this audit, ASA (FM&C) recognizes it should be recorded on the AWCF balance sheet. However, all GFM should not be recorded in the "Inventory, Work-in-Process" general ledger account. The material will be recorded in the "Inventory Held for Sale" general ledger account until the contractor issues it to be consumed in a repair or production order. When it is issued, it will be recorded in the "Inventory, Work-in-Process" general ledger account until the government accepts the secondary item being repaired or produced and records the entire value of that material in the "Inventory Held for Sale" general ledger account until sold.

ASA (FM&C), in coordination with the Deputy Chief of Staff of the Army, G-4 and Headquarters, Army Materiel Command (HQ, AMC) will develop a plan of action and milestones (POA&M) to track receipt, acceptance, and consumption of this subset of GFM within the "Inventory Held for Sale" general ledger account and the "Inventory, Work-in-Process" general ledger account as applicable. This POA&M will be complete by 31 December 2015.

Assistant Secretary of the Army (Financial Management and Comptroller) Comments (cont'd)

- b. Recommendation 2: We recommend that the Assistant Secretary of the Army (Financial Management and Comptroller) expedite efforts to transition to the consumption method of accounting for Government-furnished material, unless it can document a strong business case for using the purchase method to recognize operating materials and supplies expenses. In developing this business case, consider the capitalization effect of Government-furnished material items included for upgrades, modifications, or assembly of end items, to include general equipment.

Response: The Army concurs with this recommendation. ASA (FM&C) will research and analyze the specific scenarios where the Logistics Modernization Program (LMP) is recording the logistics transactions for Army General Fund operating materials and supplies (OM&S) furnished to contractors as GFM. The research and analysis will consider the capitalization effect of GFM items included for upgrades, modifications, or assembly of major end items, including general equipment. ASA (FM&C) will also coordinate with the Office of the Undersecretary of Defense (Comptroller) Financial Improvement and Audit Readiness (FIAR) Directorate to determine the proper accounting treatment for this material during the discovery phase of Wave 4 of the FIAR Guidance. If none of the exceptions to using the consumption method of accounting documented in the Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards (SFFAS) No. 3 apply, ASA (FM&C) will develop a POA&M to transition from the purchase method of accounting to the consumption method of accounting for this portion of OM&S. This POA&M will be complete by 30 September 2018.

- c. Recommendation 3: We recommend that the Deputy Chief of Staff of the Army, G-4, and the Assistant Secretary of the Army (Financial Management and Comptroller), in collaboration with the Commander, Army Materiel Command, develop a business process and the Logistics Modernization Program posting logic to identify and track Army Working Capital Fund inventory provided to contractors as Government-furnished material within the Logistics Modernization Program system. Specifically, the Army should use the Logistics Modernization Program system to report Army Working Capital Fund inventory provided to contractors as Government-furnished material to meet requirements in the DoD Manual 4140.01, volume 9, and DoD 7000.14-R, DoD Financial Management Regulation, volume 4, chapter 4.

Response: The Army concurs with this recommendation. The Logistics Modernization Program (LMP) is the intended system for management of GFM at the wholesale level. In December 2014, the HQ, AMC completed the change requirements document (CRD) titled CRDB 40708 for business process re-engineering of the Management Control Activity (MCA)/GFM solution in the LMP. The modernized

Assistant Secretary of the Army (Financial Management and Comptroller) Comments (cont'd)

solution will provide visibility of all orders submitted to or generated by the government supply system for GFM and provide visibility of GFM by recording shipments, material receipt acknowledgements and consumption as well as capture and maintain historical data by contract for reporting purposes.

The Deputy Chief of Staff of the Army, G-4 and the Assistant Secretary of the Army (Financial Management and Comptroller), in coordination with the HQ, AMC will take the following steps to meet the requirements in CRDB 40708: obtain Architecture Review Board approval, document the financial solution requirements, request and obtain man hours required for solution development, perform cost-benefit analysis, and staff an Army decision. This will be completed by 31 March 2016. If the decision is to proceed with development, subsequent actions will include design, development, fielding and training.

- d. Recommendation 4: We recommend that the Commander, Army Materiel Command, develop oversight procedures to ensure that Management Control Activities consistently and accurately process Government-furnished material

Response: The Army concurs with this recommendation. HQ, AMC conducted a MCA workshop 16-17 December 2014 to review the current MCA requirements. Objectives of the workshop were to rescope the MCA activities through business process reengineering, address the need for new policy, reevaluate existing LMP change requests, and identify "to be" process alternatives. On 6 April 2015, HQ AMC issued CPL 15-04-AMCOL-LOS to subordinate Life Cycle Management Commands establishing actions necessary to ensure MCAs are consistently and accurately processing GFM and performing reasonable checks on data in LMP MCA tables.

- e. Recommendation 5: We recommend that the Commander, Army Materiel Command, in coordination with each Life Cycle Management Command, validate data in the Logistics Modernization Program Management Control Activity table and perform reasonableness checks quarterly.

Response: The Army concurs with this recommendation. As noted in the response to Recommendation 4, HQ, AMC issued guidance on 6 April 2015 to the Life Cycle Management Commands regarding reasonableness checks and the updating of accountable records. As noted in the draft audit report, the LMP MCA table does not contain complete and accurate data necessary to maintain visibility of GFM. LMP system enhancements have been defined (CRDB 40708) to support:

Assistant Secretary of the Army (Financial Management and Comptroller) Comments (cont'd)

(1) The MCA requirement to maintain oversight of GFM by contract until consumed or returned to the Government at contract termination

(2) Allow the MCA process in LMP to capture contractor receipts of material shipments of final product

(3) Provide reports of GFM (item counts and investment dollars) by contract

(4) Enable the Government to monitor "fraud, waste and abuse."

Army Materiel Command Comments



REPLY TO
ATTENTION OF:

DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
4400 MARTIN ROAD
REDSTONE ARSENAL, AL 35898-5000

AMCIR

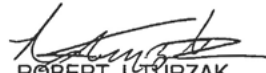
07 MAY 2015

MEMORANDUM FOR Department of Defense Inspector General (DoDIG),
[REDACTED], Program Director, Financial Management and Reporting,
4800 Mark Center Drive, Alexandria, VA 22350-1500

SUBJECT: Command Comments on DoDIG Draft Report: Army Needs to Improve
Processes over Government-Furnished Material (GFM) Inventory Actions, Project
D2014-D000FI-0138.

1. The U.S. Army Materiel Command (AMC) has reviewed the subject draft report and provides the enclosed response.
2. The AMC point of contact is [REDACTED]
or email: [REDACTED].

Encl


ROBERT J. TURZAK
Acting Executive Deputy to the
Commanding General

Army Materiel Command Comments (cont'd)



DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
4400 MARTIN ROAD
REDSTONE ARSENAL, AL. 35898-5000

REPLY TO
ATTENTION OF:

AMCOL-L

05 May 2015

MEMORANDUM FOR Inspector General U.S. Department of Defense

SUBJECT: Department of Defense (DoD) Inspector General (IG) Inspection Response to AMC Internal Review

1. Reference: DoD IG Project No. D2014-D000FI-0138.000: "Army Needs to Improve Processes over Government-Furnished Material (GFM) Inventory Actions"

Recommendation 3

We recommend that the Deputy Chief of Staff of the Army, G-4, and the Assistant Secretary of the Army (Financial Management and Comptroller), in collaboration with the Commander, Army Materiel Command, develop a business process and the Logistics Modernization Program posting logic to identify and track Army Working Capital Fund inventory provided to contractors as Government-furnished material within the Logistics Modernization Program system. Specifically, the Army should use the Logistics Modernization Program system to report Army Working Capital Fund inventory provided to contractors as Government-furnished material to meet requirements in the DoD Manual 4140.01, volume 9, and DoD 7000.14-R, DoD Financial Management Regulation, volume 4, chapter 4.

Response:

Concur. Headquarters, U.S. Army Materiel Command (HQ AMC) has initiated the requirements document for business process re-engineering (modernization) of the MCA/GFM solution in the Logistics Modernization Program system. The system change requirement (CRDB 40708) was completed in December which takes into account requirements for GFM/MCA. The modernized solution will provide visibility of all orders submitted to or generated by the government supply system for GFM and provide visibility of GFM material by recording shipments, material receipt acknowledgements and consumption as well as capture and maintain GFM historical data by contract for reporting purposes.

Recommendation 4

We recommend that the Commander, Army Materiel Command, develop oversight procedures to ensure that Management Control Activities (MCA) consistently and accurately process Government-furnished material.

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Army Materiel Command Comments (cont'd)

AMCOL-L
SUBJECT: Department of Defense (DoD) Inspector General (IG) Inspection Response

Response:

Concur. Headquarters, U.S. Army Materiel Command (HQ AMC) conducted a MCA workshop 16-17 December 2014 to review the current MCA requirements. Objectives of the workshop were to rescope the MCA activities through business process reengineering, address the need for new policy, reevaluate existing LMP change requests, and identify "to be" process alternatives. On 6 April 2015, HQ AMC issued CPL 15-04-AMCOL-LOS to subordinate Life Cycle Management Commands (LCMCs) establishing actions necessary to ensure MCAs are consistently and accurately processing GFM and performing reasonable checks on data in LMP MCA tables.

Recommendation 5

We recommend that the Commander, Army Materiel Command, in coordination with each LCMC, validate data in the Logistics Modernization Program (LMP) Management Control Activity (MCA) table and perform reasonableness checks quarterly.

Response:

Concur. As noted in the response to Recommendation 4, guidance has been issued to the LCMCs regarding reasonableness checks and to update property accountable records. As noted in the draft audit report, the LMP MCA table does not contain complete and accurate data necessary to maintain visibility of GFM. LMP system enhancements have been defined (CRDB 40708) to support:

- a. The MCA requirement to maintain oversight of GFM by contract until consumed or returned to the Government at contract termination
- b. Allow the MCA process in LMP to capture contractor receipts of material shipments of final product
- c. Provide reports of GFM (item counts and investment dollars) by contract
- d. Enable the Government to monitor "fraud, waste and abuse"

2. The point of contact for this memo is [REDACTED], Chief, Secondary Item Requirements Branch, HQ AMC G-3/4 [REDACTED].


KEVIN J. BOSTICK
Deputy Chief of Staff
for Logistic Integration, G-3/4

Acronyms and Abbreviations

AGF	Army General Fund
AMC	Army Materiel Command
AR	Army Regulation
ASA(FM&C)	Assistant Secretary of Army (Financial Management and Comptroller)
AWCF	Army Working Capital Fund
DoD FMR	DoD Financial Management Regulation
GFM	Government-Furnished Material
GLAC	General Ledger Account Code
LCMC	Life Cycle Management Command
LMP	Logistics Modernization Program
MCA	Management Control Activity
NIIN	National Item Identification Number
OM&S	Operating Materials and Supplies
PMO	Product Management Office
SFFAS	Statement of Federal Financial Accounting Standards

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