

July 2004

DEFENSE INVENTORY

Navy Needs to Improve the Management Over Government- Furnished Material Shipped to Its Repair Contractors



G A O

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Highlights of [GAO-04-779](#), a report to the Honorable Richard J. Durbin and the Honorable Tom Harkin, U.S. Senate; and the Honorable Peter A. DeFazio and the Honorable Carolyn B. Maloney, House of Representatives.

Why GAO Did This Study

GAO has reported in a number of products that the lack of control over inventory shipments increases vulnerability to undetected loss or theft and substantially increases the risk that million of dollars can be spent unnecessarily. This report evaluates the Navy's and its repair contractors' adherence to Department of Defense (DOD) and Navy inventory management control procedures for government-furnished material shipped to Navy repair contractors. Government-furnished material includes assemblies, parts, and other items that are provided to contractors to support repairs, alterations, and modifications. Generally, this material is incorporated into or attached onto deliverable end items, such as aircraft, or consumed or expended in performing a contract.

What GAO Recommends

GAO recommends that the Navy require its repair contractors to acknowledge receipt of government-furnished material, follow up on unconfirmed material receipts within the established 45 days, and implement procedures to ensure that quarterly reports of government-furnished material shipped to repair contractors are generated and distributed to the Defense Contract Management Agency. DOD concurred with GAO's recommendations and provided estimated timelines for implementation of each of the recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-04-779.

To view the full product, including the scope and methodology, click on the link above. For more information, contact William M. Solis at (202) 512-8412 or solisw@gao.gov.

DEFENSE INVENTORY

Navy Needs to Improve the Management Over Government-Furnished Material Shipped to Its Repair Contractors

What GAO Found

The Naval Inventory Control Point and its repair contractors have not followed DOD and Navy inventory management control procedures intended to provide accountability for and visibility of shipped government-furnished material to Navy repair contractors. As a result, Navy inventory worth millions of dollars is vulnerable to fraud, waste, or abuse. First, Navy repair contractors are not acknowledging receipt of government-furnished material from the Navy's supply system. Although a DOD procedure states that contractors will notify the military services' inventory control points once material is received, Naval Inventory Control Point officials are not requiring its repair contractors to do so. Consequently, the Naval Inventory Control Point is not adhering to another DOD procedure that requires the military services to follow up with repair contractors within 45 days when the receipts for items are not confirmed. Naval Inventory Control Point officials stated that receipting for government-furnished material, which is earmarked for immediate consumption in the repair of another item, might overstate the inventory levels in their inventory management system. Without material receipt notification, the Naval Inventory Control Point cannot be assured that its repair contractors have received the material. For fiscal year 2002, the most recent and complete data available at the time of GAO's review, the Naval Inventory Control Point reported that 4,229 government-furnished material shipments (representing 4,301 items value at approximately \$115 million) had been shipped to its repair contractors. GAO randomly selected and examined 308 government-furnished material shipments, representing 344 items that were shipped to the Navy's repair contractors. Based on this random sample, GAO estimated that 50 unclassified items may be unaccounted for, with a value of about \$729,000 in aircraft-related government-furnished material.

Additionally, the Naval Inventory Control Point does not send quarterly reports on the status of government-furnished material shipped to its repair contractors to the Defense Contract Management Agency. DOD and Navy procedures require that the Naval Inventory Control Point generate and distribute quarterly reports on government-furnished material shipped to repair contractors, including information on total shipments and their dollar value, number of shipments for which receipts are unknown, and rejected requisitions to the Defense Contract Management Agency. Although there are a number of DOD and Navy procedures that outline this reporting requirement, the Naval Inventory Control Point officials responsible for implementing this procedure were unaware of the requirement. The Naval Inventory Control Point lacks procedures to ensure that these reports are generated and distributed to the Defense Contract Management Agency. Without the reports, the Defense Contract Management Agency may be unable to independently verify that the Navy repair contractors have accounted for all government-furnished material shipped to them.

Contents

Letter		1
	Results in Brief	3
	Background	5
	Inventory Management Control Procedures Are Not Being Followed	8
	Conclusion	12
	Recommendations for Executive Action	12
	Agency Comments	13
Appendix I	Scope and Methodology	14
Appendix II	Comments from the Department of Defense	17
Appendix III	GAO Contact and Staff Acknowledgments	20
Related GAO Products		21
Table		
	Table 1: Fiscal Year 2002 Government-Furnished Material Shipments by Number and Value	6

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United States Government Accountability Office
Washington, DC 20548

July 23, 2004

The Honorable Richard J. Durbin
The Honorable Tom Harkin
United States Senate

The Honorable Peter A. DeFazio
The Honorable Carolyn B. Maloney
House of Representatives

As we have reported in a number of our products, the lack of control over inventory shipments increases vulnerability to undetected loss or theft and substantially increases the risk that millions of dollars will be spent unnecessarily. Since at least 1990, we have considered Department of Defense (DOD) inventory management to be a high-risk area because inventory management systems and procedures are ineffective. (A list of related GAO products appears at the end of this report.)

In July 2002, we reported on the Air Force's noncompliance with inventory management control procedures that led to inventory worth billions of dollars being vulnerable to fraud, waste, or abuse.¹ In response to your request for us to review the Navy and Army inventory management procedures for controlling inventory shipped to repair contractors, we evaluated the Navy's and its repair contractors' adherence to DOD and Navy inventory management control procedures for government-furnished material² shipped to Navy repair contractors. As agreed with your offices, we plan to initiate a review of the Army's and its repair contractors' adherence to DOD and Army inventory management control procedures for shipped government-furnished material, as well as items for repair that are provided to Army repair contractors.

¹ U.S. General Accounting Office, *Defense Inventory: Air Force Needs to Improve Control of Shipments to Repair Contractors*, [GAO-02-617](#) (Washington, D.C.: July 1, 2002).

² Government-furnished material is material in the possession of, or acquired by, the government and later delivered or otherwise made available to a contractor. It includes assemblies, components, parts, raw and process material, and small tools and supplies that contractors use in support of repairs, alterations, and modifications. Generally, this material is incorporated into or attached onto deliverable end items, such as aircraft, or consumed or expended in performing a contract. Additional details regarding how the Navy further defines government-furnished material are included in appendix I.

The Navy contracts with private companies (i.e., repair and production contractors) to produce, maintain, and repair its equipment. In some cases, the Navy furnishes the material necessary to perform the repairs at the contractors' locations. Responsibility for controlling this material is shared among the Naval Supply Command, the Naval Inventory Control Point, the Defense Logistics Agency, repair contractors, and the Defense Contract Management Agency. The Naval Supply Command administers the Navy's supply system and provides inventory management policies and procedures. The Naval Inventory Control Point procures, manages, and supplies inventory for naval aircraft, submarines, and ships worldwide.³ The Defense Contract Management Agency assesses the accuracy of repair contractor records and accounts for all government property furnished to a contractor.⁴

Our objective was to determine whether the Naval Inventory Control Point and its repair contractors adhere to DOD and Navy inventory management control procedures governing the accountability for and visibility of shipped government-furnished material. We did not review the Navy inventory management control procedures for items needing repair that are provided to Navy contractors because of a recent June 2003 DOD Office of the Inspector General report.⁵ While the Inspector General's report indicated that the Navy had taken actions to improve its procedures and controls to account for these items at commercial repair facilities, it found that additional improvements were needed to improve the monitoring and oversight of shipped inventory.⁶

To assess the Naval Inventory Control Point's and its repair contractors' adherence to DOD and Navy inventory management control procedures

³ The Naval Inventory Control Point serves as the Management Control Activity for the Navy Supply Command. The Management Control Activity is a Navy activity or DOD activity delegated by the Navy that is responsible for validating all requisitions for government-furnished material shipped to contractors. The Management Control Activity is also responsible for submitting government-furnished material status reports to the Defense Contract Management Agency.

⁴ The Defense Contract Management Agency property administrators are charged with carrying out this responsibility.

⁵ Department of Defense Office of the Inspector General, *Logistics: Followup Audit of Depot-Level Repairable Assets at Selected Army and Navy Organizations*, D-2003-098 (Arlington, Virginia: June 5, 2003).

⁶ Until the inventory reaches its intended destination, the Naval Inventory Control Point refers to it as in-transit, which is also referred to as shipped inventory.

related to government-furnished material shipped to repair contractors, we randomly selected and examined 308 government-furnished material shipments. These shipments represented 344 items that were shipped to Navy repair contractors in fiscal year 2002, the most recent and complete data available at the time of our review. We sent surveys to 29 Navy repair contractors requesting data on these unclassified, classified, and sensitive shipments valued at about \$11.9 million.⁷ We received survey responses from 20 of the 29 contractors, representing 207 government-furnished material shipments (corresponding to 243 items). Our review focused on the Naval Inventory Control Point facility located in Philadelphia, Pennsylvania, which manages aircraft-related inventory.⁸ We assessed the reliability of the data used in this report and determined that the data were sufficiently reliable for our purposes.

We conducted our review from March 2003 through April 2004 in accordance with generally accepted government auditing standards. More details about our scope and methodology appear in appendix I.

Results in Brief

The Naval Inventory Control Point and its repair contractors have not followed DOD and Navy procedures intended to provide the accountability for and visibility of inventory shipped to Navy repair contractors. Specifically, Navy repair contractors are not routinely acknowledging receipt of government-furnished material received from the Navy. A DOD procedure requires repair contractors to acknowledge receipt of government-furnished material⁹ that has been shipped to them from the Navy's supply system.¹⁰ However, Naval Inventory Control Point officials are not requiring repair contractors to acknowledge receipt of government-furnished material that they have received from this system. By not requiring repair contractors to acknowledge receipt of government-furnished material, the Naval Inventory Control Point has also departed

⁷ Classified items are those that require the highest degree of protection in the interest of national security. Sensitive items—those that are high value, highly technical, or hazardous in nature and small arms, ammunition, explosives, and demolition material—require a high degree of protection and control due to statutory requirements or regulations.

⁸ Hereafter referred to as Naval Inventory Control Point.

⁹ DOD 4000.25-2-M, *Military Standard Transaction Reporting and Accounting Procedures (MILSTRAP)*, September 2001 (as amended by changes 1&2), paragraph C6.6.

¹⁰ For purposes of this report, the Navy's supply system refers to inventory stored at and shipped from Navy warehouses, contractor facilities, and manufacturer facilities.

from the procedure to follow up with the contractor within 45 days when the contractor fails to confirm receipt for an item.¹¹ Without material receipt notification, the Naval Inventory Control Point cannot be assured that its repair contractors have received the shipped material. This failure to acknowledge receipt of material shipped to repair contractors can potentially impair the Navy's ability to account for shipments leading to possible fraud, waste, or abuse. For fiscal year 2002, the most recent and complete data available at the time of our review, the Naval Inventory Control Point reported that 4,229 government-furnished material shipments had been shipped to its repair contractors. These shipments had a value of approximately \$115 million. We randomly selected and examined 308 government-furnished material shipments, valued at approximately \$11.9 million, and surveyed 29 Navy repair contractors to determine if they had recorded receipts for these shipments in their property records. The Navy repair contractors had documented receipts for all classified shipments. However, they were unable to document the receipts for 4 of the unclassified shipments (representing 4 items) in our sample. Because our sample was randomly selected, it was estimated that 50 unclassified items may be unaccounted for, with a value of about \$729,000 in inventory of aircraft-related government-furnished material for fiscal year 2002.¹²

Additionally, the Naval Inventory Control Point does not send quarterly reports on the status of shipped material to the Defense Contract Management Agency. DOD and Navy procedures require that the Naval Inventory Control Point generate quarterly reports on government-furnished material shipped to repair contractors, including information on total shipments and their dollar value, number of shipments for which receipts are unknown, and rejected requisitions to the Defense Contract Management Agency.¹³ However, the Naval Inventory Control Point does not have procedures in place to ensure that these quarterly reports are

¹¹ DOD 4000.25-2-M, *Military Standard Transaction Reporting and Accounting Procedures (MILSTRAP)*, September 2001 (as amended by changes 1&2), paragraph C6.7.

¹² This is the mean value based on our analysis. We are 95 percent confident that between 4 and 98 items are unaccounted for with a value of between \$58,300 and \$1,428,350.

¹³ DOD 4140.1-R, *DoD Supply Chain Materiel Management Regulation*, May 23, 2003, paragraph C5.11.2.4; DOD 4161.2-M, *DoD Manual for the Performance of Contract Property Administration*, December 1991, paragraph C5.2.6; and SECNAVINSTR 4440.32A, *Control of Contractor Access to DoD Material Inventories and Determinations for the Supply of Government Furnished Material*, September 27, 1991, paragraph 6d(5)(b).

generated and distributed to the Defense Contract Management Agency. Without these reports, the Defense Contract Management Agency may be unable to conduct an independent verification that the Navy repair contractors have accounted for all government-furnished material shipped to them.

We are making three recommendations to strengthen the Navy's compliance with existing inventory management procedures for controlling government-furnished material shipped to its repair contractors. In written comments on a draft of this report, DOD concurred with our recommendations and provided estimated timelines for implementation of each of the recommendations.

Background

The Naval Inventory Control Point authorizes movement of its inventory from the Defense Logistic Agency,¹⁴ Navy-managed shipping and receiving activities, and Navy repair contractors. With prior approval from Naval Inventory Control Point item managers, Navy repair contractors can also use material located at their facilities. DOD procedures and Federal Acquisition Regulation procedures generally require that repair contractors establish and maintain an internal property control system for the control, use, maintenance, repair, protection, and preservation of government property in their possession.¹⁵

The Navy currently has 359 repair contractors using its Web-based inventory management system, known as the DOD Commercial Asset Visibility System. This system provides the Navy with asset reporting coverage for more than 95 percent of its commercial repair business.

For fiscal year 2002, the most recent and complete data available at the time of our review, the Naval Inventory Control Point reported that 4,229 government-furnished material shipments (representing 4,301 items valued at approximately \$115 million) had been shipped to its repair contractors. Table 1 shows the derivation of the sample size of our survey, including the number and value of shipments for which we received survey responses.

¹⁴ The Defense Logistics Agency—which operates and manages 23 storage depots—receives, stores, and issues inventory and maintains inventory records.

¹⁵ DOD 4161.2-M, *DoD Manual for the Performance of Contract Property Administration*, December 1991, paragraph C3.4; Federal Acquisition Regulation (FAR), Subpart 45.502.

Table 1: Fiscal Year 2002 Government-Furnished Material Shipments by Number and Value

Categories of government-furnished material shipments	Number of shipments	Number of items	Value
Universe of shipments to Navy repair contractors	4,229	4,301	\$115,310,392
Audit sample shipments			
• Unclassified and sensitive	302	338	9,652,910
• Classified	6	6	2,241,116
Total sample shipments	308	344	\$11,894,026
Total shipments captured in survey responses^a	207	243	\$9,922,155

Source: GAO's analysis of Naval Inventory Control Point data.

^aThese shipments represent 67 percent of the total sample shipments. All classified shipments and dollar values are included in this category. Nine of the repair contractors in our survey did not provide data for the remaining 101 shipments, or 33 percent of our total sample.

DOD requires the Navy to use a number of procedures to monitor items shipped to and received by repair contractors. First, the recipient of the material is responsible for notifying the Naval Inventory Control Point once an item has been received. If the Naval Inventory Control Point has not been provided a receipt within 45 days of shipment, it is required to follow up with the intended recipient.¹⁶ The rationale behind these requirements is that until receipt is confirmed, the exact status of the shipment is uncertain and therefore vulnerable to fraud, waste, or abuse. The Naval Inventory Control Point is also required by DOD and Navy procedures to submit quarterly reports to the Defense Contract Management Agency identifying all government-furnished material that has been provided to a contractor.¹⁷ These reports allow the Defense Contract Management Agency to independently verify that Navy repair contractors have accounted for all government-furnished material shipped

¹⁶ DOD 4000.25-2-M, *Military Standard Transaction Reporting and Accounting Procedures (MILSTRAP)*, September 2001 (as amended by changes 1&2), paragraphs C6.6 and C6.7.

¹⁷ DOD 4140.1-R, *DoD Supply Chain Materiel Management Regulation*, May 23, 2003, paragraph C5.11.2.4; DOD 4161.2-M, *DoD Manual for the Performance of Contract Property Administration*, December 1991, paragraph C5.2.6; and SECNAVINST 4440.32A, *Control of Contractor Access to DoD Material Inventories and Determinations for the Supply of Government Furnished Material*, September 27, 1991, paragraph 6d(5)(b).

to them. As a result, the Defense Contract Management Agency does not have to rely strictly on records provided by Navy repair contractors.

In addition to these DOD and Navy procedures, the Navy, as a representative of the federal government, is also obligated to establish and maintain effective internal control systems. The Federal Managers' Financial Integrity Act of 1982¹⁸ requires the General Accounting Office to issue standards for internal control in government.¹⁹ According to these standards, internal control is defined as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations. A subset of these objectives is the safeguarding of assets. Internal control should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use, or disposition of an agency's assets. Effective and efficient internal control activities help ensure that an agency's control objectives are accomplished. The control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives, such as the process of adhering to DOD requirements for receipt of government-furnished material and issuance of quarterly government-furnished material status reports.

DOD annually ships inventory valued at billions of dollars to various locations around the world. For years, DOD has had difficulty tracking this inventory from origin to destination. The accountability problem with shipped inventory is part of a more global issue. Since at least 1990, we have considered DOD's inventory management to be a high-risk area because DOD's inventory management procedures are ineffective. The lack of adequate controls over shipped inventory and the resulting vulnerability to undetected loss or theft have been major areas of concern. In March 1999, we reported that significant weaknesses existed at all levels of the Navy's shipped inventory management structure, leading to potential theft or undetected losses of items and demonstrating inefficient

¹⁸ 31 U.S.C. 3512(b).

¹⁹ U.S. General Accounting Office, *Internal Control: Standard for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: Nov. 1999).

and ineffective logistics management practices.²⁰ We concluded that these weaknesses and the problems they created were primarily a result of the Navy not following its own procedures regarding controls over shipped inventory. In following up with the Navy, we found that the Navy had implemented many of our recommendations that have improved the accountability over its shipped inventory. According to Naval Inventory Control Point officials, at least 75 percent of their shipped inventory discrepancies have been resolved. Also, according to a June 2003 DOD Office of the Inspector General report, the Navy had taken actions to improve its procedures and controls to account for items repaired at commercial repair facilities. However, the DOD Office of the Inspector General found that additional improvements were needed to improve the monitoring and oversight of shipped inventory.²¹

Inventory Management Control Procedures Are Not Being Followed

The Naval Inventory Control Point and its repair contractors are not following DOD inventory management control procedures governing the accountability for and visibility of government-furnished material shipped to its repair contractors. As a result, this inventory is vulnerable to loss or theft. First, the Naval Inventory Control Point is not following a DOD procedure that requires repair contractors to acknowledge receipt of government-furnished material that has been shipped to them from the Navy's supply system. Consequently, the Naval Inventory Control Point is not following another DOD procedure that requires it to follow up with its repair contractors that have not confirmed receipt of shipped material. Additionally, the Naval Inventory Control Point is not following DOD and Navy procedures that require quarterly reports on the status of government-furnished material shipped to Navy repair contractors be provided to the Defense Contract Management Agency.

²⁰ U.S. General Accounting Office, *Defense Inventory: Navy's Procedures for Controlling In-Transit Items Are Not Being Followed*, GAO/NSIAD-99-61 (Washington, D.C.: Mar. 31, 1999).

²¹ Department of Defense Office of the Inspector General, *Logistics: Followup Audit of Depot-Level Repairable Assets at Selected Army and Navy Organizations*, D-2003-098 (Arlington, Virginia: June 5, 2003).

Navy Is Not Requiring Its Repair Contractors to Acknowledge Receipt of Government-Furnished Material

Navy repair contractors are not routinely acknowledging receipt of government-furnished material that has been shipped to them from the Navy's supply system. According to a DOD procedure, repair contractors must enter shipments into their inventory records and notify the inventory control point when material has been received. This material receipt acknowledgment is designed to maintain accountability for all shipped items, including government-furnished material that has been shipped to Navy repair contractors in usable condition from the Navy's supply system. Additionally, the Navy must adhere to internal control standards outlined by the General Accounting Office, such as providing assurance that assets are safeguarded against unauthorized acquisition, use, or disposition.

Navy repair contractors are not routinely adhering to the DOD procedure to acknowledge receipt of government-furnished material shipped to them because Naval Inventory Control Point officials are not requiring them to do so. By not requiring repair contractors to receipt, the Naval Inventory Control Point does not follow up with its repair contractors within 45 days—as required by DOD procedure—when these repair contractors fail to confirm receipt of government-furnished material shipped to them. Naval Inventory Control Point officials acknowledged that they only become aware that a contractor has not received an item if the contractor inquires about the shipment.

Naval Inventory Control Point personnel provided several reasons why Navy repair contractors are not being required to notify the Naval Inventory Control Point of material receipt. They indicated that the Naval Inventory Control Point does not require its repair contractors to acknowledge receipt of government-furnished material because such material is provided with the expectation that it will immediately be consumed in the repair of other items. Naval Inventory Control Point officials also stated that submitting notification of receipt for this material might overstate the inventory levels in the DOD Commercial Asset Visibility System—the Navy's inventory management system—because the system would show this material as on-hand at its repair contractors' facilities when the material is actually earmarked for immediate use in the repair of another item.

We have noted the Naval Inventory Control Point officials' concerns about the potential for notification of receipt of government-furnished material to overstate inventory levels. However, one of the Navy repair contractors in our review currently uses the DOD Commercial Asset Visibility System to enter receipt of government-furnished material, without overstating the

inventory levels maintained within the system. Specifically, the Navy repair contractor is using a standard module of the DOD Commercial Asset Visibility System to enter receipt of material received in usable condition from the Navy's supply system. Upon entering a receipt of material in the system, the contractor then issues the item to itself for immediate use in the repair of another item. This process eliminates the possibility of adverse impacts to inventory levels. However, the Naval Inventory Control Point is not using this module of the DOD Commercial Asset Visibility System for the receipt of material received in usable condition. Additionally, in our previous Air Force report on shipments to repair contractors,²² we found that in contrast to the Navy, the Air Force requires repair contractors to issue a notification of receipt for material that they have received.

For fiscal year 2002, the most recent and complete data available at the time of our review, the Naval Inventory Control Point reported that 4,229 government-furnished material shipments (representing 4,301 items valued at approximately \$115 million) had been shipped to its repair contractors. We randomly selected and examined 308 government-furnished material shipments, representing 344 items that were shipped to Navy repair contractors. We surveyed 29 Navy repair contractors to determine if they had recorded receipts for these shipments in their property records. The repair contractors had recorded receipts for all classified shipments. However, they could not document the receipt of 4 unclassified shipments (representing 4 items). Because our sample was randomly selected, the results can be projected to the entire universe of government-furnished material managed by the Naval Inventory Control Point. We estimate that 50 unclassified items may be unaccounted for, with a value of about \$729,000 in inventory of aircraft-related government-furnished material for fiscal year 2002.²³

Lack of contractor notification has impeded the Naval Inventory Control Point's visibility of government-furnished material. Without such notification, the Naval Inventory Control Point cannot be assured that its repair contractors have received all shipped material. Finally, because the Naval Inventory Control Point does not have data on unconfirmed government-furnished material shipments, it lacks the ability to

²² See [GAO-02-617](#).

²³ This is the mean value based on our analysis. We are 95 percent confident that between 4 and 98 items are unaccounted for with a value of between \$58,300 and \$1,428,350.

Navy Is Not Submitting
Required Quarterly Reports

independently know when corrective actions, such as resolving inventory discrepancies, are needed. As a result, the Navy's inventory continues to be at risk of fraud or loss.

The Naval Inventory Control Point is also not following DOD and Navy procedures that require Naval Inventory Control Point officials to provide the Defense Contract Management Agency with quarterly status reports showing all shipments of government-furnished material that have been provided to its repair contractors.²⁴ According to the procedures, these reports should include information about total shipments and their dollar value, number of shipments for which receipts are unknown, and rejected requisitions. The purpose of the reports is to assist the Defense Contract Management Agency in independently verifying contractor records of government-furnished material.

A Navy procedure designates individuals within the inventory control point to serve as the management control activity to, among other things, generate and distribute the required quarterly government-furnished material status reports.²⁵ According to Naval Inventory Control Point and Defense Contract Management Agency officials, the inventory control point has not provided the Defense Contract Management Agency with the required quarterly reports. The inventory control point officials stated that they were unaware of the requirement to provide quarterly reports to the Defense Contract Management Agency. Although a number of standard DOD and Navy inventory management control procedures stipulate the requirement to generate and distribute the quarterly reports, inventory control point officials lack recognition of this reporting requirement. The Naval Inventory Control Point currently lacks procedures to ensure that these quarterly reports are generated and distributed to the Defense Contract Management Agency as required by DOD and Navy procedures.

²⁴ DOD 4140.1-R, *DoD Supply Chain Materiel Management Regulation*, May 23, 2003, paragraph C5.11.2.4; DOD 4161.2-M, *DoD Manual for the Performance of Contract Property Administration*, December 1991, paragraph C5.2.6; and SECNAVINST 4440.32A, *Control of Contractor Access to DoD Material Inventories and Determinations for the Supply of Government Furnished Material*, September 27, 1991, paragraph 6d(5)(b).

²⁵ SECNAVINST 4440.32A, *Control of Contractor Access to DoD Material Inventories and Determinations for the Supply of Government Furnished Material*, September 27, 1991, paragraphs 4c and 6d(2)(d).

Proper distribution of the quarterly status reports is vital to the management of government-furnished material. A 1995 DOD Inspector General audit report of management access to DOD's supply system asserted that the Defense Contract Management Agency serves as the last line of defense in protecting material resources and needs an independent record of the government-furnished material shipped to repair contractors. These quarterly reports serve as such a record and prevent the Defense Contract Management Agency from having to rely solely on the repair contractors' records of government-furnished material.

Conclusion

Inventory worth millions of dollars is vulnerable to fraud, waste, or abuse because the Naval Inventory Control Point is not adhering to DOD inventory management control procedures for government-furnished material shipped to its repair contractors. Because the Naval Inventory Control Point has not required its repair contractors to acknowledge receipt of government-furnished material, it will continue to lack assurance that its repair contractors have received shipped material. In addition, without requiring receipts, the Naval Inventory Control Point will be unable to follow up on unconfirmed material receipts within the required 45 days. As a result, the Naval Inventory Control Point will continue to lose the ability to understand inventory management weaknesses and take necessary corrective action. Furthermore, without the Naval Inventory Control Point implementing procedures to ensure that quarterly reports for all shipments of government-furnished material to its repair contractors are generated and distributed to the Defense Contract Management Agency, the Defense Contract Management Agency might be impaired in its ability to serve as the last line of defense in protecting government-furnished material.

Recommendations for Executive Action

To improve the control of government-furnished material shipped to Navy repair contractors, we recommend that the Secretary of Defense direct the Secretary of the Navy to instruct the Commander, Naval Inventory Control Point, to implement the following three actions:

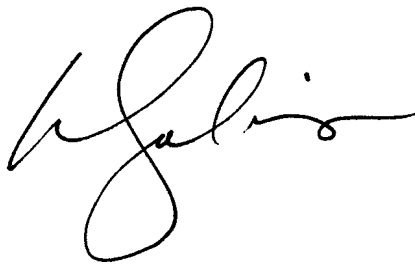
- Require Navy repair contractors to acknowledge receipt of material that is received from the Navy's supply system as prescribed by DOD procedure.
- Follow up on unconfirmed material receipts within the 45 days as prescribed in the DOD internal control procedures to ensure that the Naval Inventory Control Point can reconcile material shipped to and received by its repair contractors.

-
- Implement procedures to ensure that quarterly reports of all shipments of government-furnished material to Navy repair contractors are generated and distributed to the Defense Contract Management Agency.

Agency Comments

In written comments on a draft of this report, DOD concurred with our recommendations and provided estimated timelines for implementation of each of the recommendations. DOD's written comments on this report are reprinted in their entirety in appendix II.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to the appropriate congressional committees; the Secretary of Defense; the Secretary of the Navy; the Director, Office of Management and Budget; and the Director, Defense Logistics Agency. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.



William M. Solis
Director
Defense Capabilities and Management

Appendix I: Scope and Methodology

For the purposes of this review, government-furnished material is defined as either (1) usable items (commonly referred to as “A” condition items that the Naval Inventory Control Point directs to be shipped from Navy wholesale warehouses to its repair contractors or (2) items that the Navy repair contractors have repaired to usable condition and issued to themselves to use in completing the repair of another item. According to Naval Inventory Control Point officials, their use of government-furnished material occurs in three different circumstances where an item is needed to complete the repair of another item because the item in question is (1) missing when the other item is inducted for repair, (2) beyond repair or beyond economical repair, or (3) needed to complete the expeditious repair of another item.

To assess the Naval Inventory Control Point’s and its repair contractors’ adherence to procedures for controlling government-furnished material, we took the following steps:

- To identify criteria for controlling shipped inventory, we reviewed Department of Defense (DOD) and Navy procedures, obtained other relevant documentation related to shipped inventory, and discussed inventory management procedures with officials from the following locations: Headquarters, Department of the Navy, Washington, D.C.; the Naval Inventory Control Point; Mechanicsburg, Pennsylvania; the Naval Inventory Control Point, Philadelphia, Pennsylvania; and the Defense Contract Management Agency, Alexandria, Virginia.
- Because of long-standing problems with the accuracy of data in DOD’s inventory management systems, we took a number of measures to assess the reliability of the Naval Inventory Control Point’s data. To assess the data, we performed electronic testing for obvious errors in accuracy and completeness in the data on government-furnished material shipped to Navy repair contractors. When we found discrepancies in the data, such as missing data elements and data entry errors, we brought them to the Naval Inventory Control Point officials’ attention and worked closely with them to correct the discrepancies before conducting our analysis. In addition, we statistically selected a random sample of the Navy’s data for review. This sampling methodology enabled us to independently verify the overall accuracy of the Navy’s data on government-furnished material shipped to Navy repair contractors.
- To identify the number, value, and classification of the government-furnished material shipments, we obtained computerized supply records from the Navy’s transaction history file of all shipments between October 2001 and September 2002 from the Naval Inventory Control

Point's two office locations—Philadelphia and Mechanicsburg, Pennsylvania. The records contained descriptive information about each shipment, including document number, national stock number, quantity shipped, classification, and source of supply. After some preliminary data analysis, we excluded all records from the Mechanicsburg office due to the data set mistakenly capturing nongovernment-furnished material as government-furnished material.

- To select Navy repair contractors and items shipped to them, we used computerized shipment data obtained from the Naval Inventory Control Point's transaction history file, including data such as national stock number, quantity, source of supply, and transaction dates. We randomly selected 302 unclassified or sensitive shipments (representing 338 items) and selected the total population of 6 classified shipments (representing 6 items) that were issued to Navy repair contractors in fiscal year 2002 as government-furnished material. We randomly selected and sent surveys to 29 Navy repair contractors (associated with 83 unique repair contracts) for our review. We received survey responses from 20 of the 29 Navy repair contractors, representing 207 government-furnished material shipments (corresponding to 243 items). Four of these Navy repair contractors received the 6 shipments of classified shipments. Because the number of Navy repair contractors and government-furnished material shipments were randomly selected, the results of our analysis can be projected to all Navy repair contractors and shipments.
- To determine how Navy repair contractors are granted access to government-furnished material (i.e., federal supply class or stock number), we conducted a modified statistical sample of the various contractual agreements between the Navy and its repair contractors. We initially planned to manually review a subset of 40 contracts associated with our sample shipments to determine how the government-furnished material was identified in the contract. However, we revised our approach when we discovered that the Navy's inventory management system had the functionality to match each of our items by stock number to the associated Navy repair contracts and contractors that are repairing the items. As a result, we reviewed all of the contracts associated with our sample shipments. We found each of our sample shipments was listed by national item identification number in the contractual repair agreement and based on certain circumstances (such as items are missing on induction, broken beyond economical repair, or are needed for the expeditious repair of another higher assembly item), these items were furnished to the contractor as government-furnished material.

- To determine whether Navy repair contractors had received and accounted for our selected shipments, we surveyed each randomly selected contractor to assess whether government-furnished material shipments delineated in the Naval Inventory Supply Control Point's supply records had been received and entered into the contractor's property control records.
- To determine what happened to sample shipments that had reportedly not been received by the Navy repair contractors, we provided a listing to the Naval Inventory Control Point in Philadelphia for further review. To learn whether issues associated with unaccounted for shipments were adequately resolved, we reviewed Department of Defense, Navy, and Naval Inventory Control Point implementing guidance. Such information provided the basis for conclusions regarding the adherence to procedures for controlling shipped inventory.

The Navy repair contractors that responded to our survey were BAE Flight Systems, Nashua, New Hampshire; Boeing, Jacksonville, Florida; Lockheed Martin, Marietta, Georgia; Lockheed Martin, Oswego, New York; Lockheed Martin, Syracuse, New York; Northrop Grumman, Bethpage, New York; Northrop Grumman, Woodland Hills, California (two locations); Systems and Electronics, Inc., Sanford, Florida; Raytheon, Indianapolis, Indiana; Raytheon, Goleta, California; Raytheon, McKinney, Texas; Raytheon Technical Services Corp., Indianapolis, Indiana; General Dynamics, Bloomington, Minnesota; Global Technical Systems, Virginia Beach, Virginia; Sikorsky Aircraft, Shelton, Connecticut; Rockwell Collins, Cedar Rapids, Iowa; Beaver Aerospace, Livonia, Michigan; L3 Communications, Alpharetta, Georgia; and Parker Hannifin, Irvine, California.

Our work was performed from March 2003 through April 2004 in accordance with generally accepted government auditing standards.

Appendix II: Comments from the Department of Defense



DEPUTY UNDER SECRETARY OF DEFENSE FOR
LOGISTICS AND MATERIEL READINESS
3500 DEFENSE PENTAGON
WASHINGTON, DC 20301-3500

JUN 29 2004

Mr. William Solis
Director, Defense Capabilities and Management
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Solis:

This is the Department of Defense (DoD) response to the GAO draft report GAO-04-779, "DEFENSE INVENTORY: Navy Needs to Improve the Management Over Government-Furnished Material Shipped to Its Repair Contractors, dated May 26, 2004 (GAO Code 350337).

The Department concurs with all three recommendations in the draft report. Enclosed are detailed comments to the recommendations. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

Jon Kratz
for

Bradley Berkson
Acting

Enclosure:
As stated



GAO CODE 350337/GAO-04-779

**“DEFENSE INVENTORY: NAVY NEEDS TO IMPROVE THE
MANAGEMENT OVER GOVERNMENT-FURNISHED
MATERIAL SHIPPED TO ITS CONTRACTORS”**

**DEPARTMENT OF DEFENSE COMMENTS
TO THE RECOMMENDATIONS**

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Secretary of the Navy to instruct the Commander, Naval Inventory Control Point (NICP) to require Navy repair contractors to acknowledge receipt of material that is received from the Navy supply system as prescribed by DoD procedure. (Page 14/Draft Report)

DoD RESPONSE: Concur. The majority of Navy repair contracts already mandate receipt-reporting requirements for material shipped to commercial contractors. The primary application used to acknowledge receipt is DoD’s web-based Commercial Asset Visibility (CAV) system. This system will require modifications to enable NAVICP to effectively receipt for Government-Furnished Material (GFM) material. NAVICP will submit a program change request to Navy Supply Information Systems Activity (NAVSISA) to develop the required modifications to accommodate implementing the recommendation. Currently, receipt-reporting for GFM is not mandated in Navy repair contracts. For the last ten years, NAVICP has “expensed” GFM as a cost of repair, and receipt acknowledgement from contractors was not obtained. Following program changes, NAVICP will therefore also modify its contractual vehicles to include requirements for acknowledging receipt of GFM material. Estimated timeline for contracts modification is six months after program changes are completed.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct the Secretary of the Navy to instruct the Commander, Naval Inventory Control Point to follow-up on unconfirmed material receipts within the 45 days as prescribed in the DoD internal control procedures to ensure that the Naval Inventory Control Point can reconcile material shipped to and received by its repair contractors. (Page 14/Draft Report)

DoD RESPONSE: Concur. The Navy’s Stock-In-Transit (SIT) application, PM76, currently has the functionality required to generate follow-ups for GFM material shipped to commercial contractors. However, in order to successfully perform the reconciliation needed to generate a follow-up, the CAV program changes highlighted above will need to be made to capture all GFM material receipts. NAVICP will submit program change requests to NAVSISA for the development of modifications needed to fully implement GAO recommendation number two. With program changes in place, NAVICP will have the required tools to reconcile material shipped and received by repair contractors. The Navy will continue to “expense” GFM material until all required program changes have been completed. Estimated timeline for implementation is one year after program changes are completed.

RECOMMENDATION 3: The GAO recommended that the Secretary of Defense direct the Secretary of the Navy to instruct the Commander, Naval Inventory Control Point to implement procedures to ensure that quarterly reports of all shipments of government-furnished material to Navy repair contractors are generated and distributed to the Defense Contract Management Agency Officials. (Page 14/Draft Report)

DoD RESPONSE: Concur. Current IT systems do not have the functionality to provide quarterly data report required by SECNAV instruction 4440.32A. Therefore, Naval Inventory Control Point will request appropriate programming changes to NAVSISA to develop automated interfaces and functionality needed to extract GFM shipment information. Once these automated tools and interfaces are in place, NAVICP will provide quarterly reports to DCMA for all shipments of GFM material. Estimated timeline for implementation is one year after program changes are completed.

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

William M. Solis, (202) 512-8412

Acknowledgments

In addition to the contact listed above, Lawson Gist, Jr., Jacqueline S. McColl, Corrie J. Dodd, Anthony C. Fernandez, Arthur L. James, Jr., Stanley J. Kostyla, David A. Mayfield, and Robert K. Wild made key contributions to this report.

Related GAO Products

Defense Inventory: Air Force Needs to Improve Control of Shipments to Repair Contractors. [GAO-02-617](#). Washington, D.C.: July 1, 2002.

Performance and Accountability Series: Major Management Challenges and Program Risks—Department of Defense. [GAO-01-244](#). Washington, D.C.: January 1, 2001.

High-Risk Series: An Update. [GAO-01-263](#). Washington, D.C.: January 1, 2001.

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