



INSTALLATION REPORT OF AUDIT

F2007-0043-FCI000

**Assets at Contractor Facilities
Ogden Air Logistics Center
Hill AFB UT**

Hill Area Audit Office

30 May 2007

INTRODUCTION

Contractor assets consist of Government owned material located at contractor facilities awaiting repair or installation on an end item (e.g., spare aircraft or missile parts). Generally, contractors are required to report asset quantities in the Government Furnished Material and End Item Transaction Reporting System (G009). These asset quantities then overlay to the Secondary Items Requirements Computation System (D200A) and are used to compute asset requirements. As of September 2006, two Ogden Air Logistics Center repair contracts totaling \$83 million had Government owned material at the contractor location.

OBJECTIVES

This was part of a centrally directed audit to evaluate the accuracy of Air Force Materiel Command spare parts inventory balances in the requirements systems and associated feeder systems. Specifically, we evaluated the management and accuracy of reported asset inventory balances for items being repaired at contractor locations.

CONCLUSIONS

Overall, the requirements computation systems did not have accurate inventory balances. Specifically,

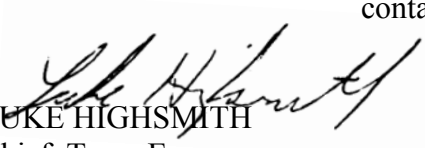
- The landing gear product management team did not accurately maintain end item inventory balances in the D200A requirements system. Accurately file maintaining D200A requirements system end item inventories will improve requirements computations. (Tab A, page 1)
- The guidance system team could improve controls over sensitive Government owned material awaiting demilitarization and disposal. Improving controls over sensitive Government owned material totaling 1.1 million items and valued at over \$404.9 million, may prevent inadvertent technology transfers, unintentional use by hostile parties, and reduce the risk for fraud, waste, and abuse. (Tab B, page 4)

RECOMMENDATIONS

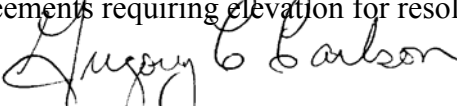
We made three recommendations to improve the process for managing Government owned material in the possession of contractors. (Reference the individual Tabs for specific recommendations.)

**MANAGEMENT'S
RESPONSE**

Management comments addressed the issues raised in this report's audit results and management alternative corrective actions planned and taken should correct the problems. This report contains no disagreements requiring elevation for resolution.



LUKE HIGHSMITH
Chief, Team E



GREGORY C. CARLSON
Chief, Hill Area Audit Office

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BACKGROUND

The product management team, consisting of the production and inventory management specialists is responsible for the control, maintenance, and accountability of aircraft reparable spare parts inventories. Generally, aircraft reparable spare parts inventories in the possession of contractors must be accounted for in the Government Furnished Material and End Item Transaction Reporting System (G009). The G009 reporting system establishes and maintains quantitative and monetary inventories of Government owned material and end item assets that are received, repaired, condemned, in-work and in-transit. Quarterly, aircraft reparable spare parts inventory balances in the G009 reporting system are transferred to the Secondary Item Requirements System (D200A) which is used to compute future procurement and repair requirements. The product management team reviews and validates asset balances that were overlaid to the D200A requirements system and quarterly files maintains or manually updates inventory balances to improve the accuracy of the requirements computations.

AUDIT RESULTS 1 – BALANCES

Condition. The landing gear product management team did not accurately maintain end item inventory balances in the D200A requirements system. Specifically, a records-to-floor inventory identified 20 (47 percent) of 43 line items with erroneous balances. The following table illustrates the top five errors by net total variance.

National Stock Number	Auditor Count		Final D200 ¹		Total Variance	
	Quantity	Value	Quantity	Value	Quantity	Value
1620 01 515 8559	49	\$ 9,921,228	46	\$ 9,313,806	3	\$ 607,422
1620 01 143 0384	191	8,027,816	174	7,313,298	17	714,518
1620 00 365 4001	120	1,862,641	72	1,117,585	48	748,056
1620 01 515 8560	42	9,491,784	38	8,587,804	4	903,979
1620 00 677 6681	4	62,088	63	977,887	59	915,799

Table 1. Five Largest Records-to-Book Inventory Variances

Cause. Production Management Specialists stated this condition occurred because of interface delays and uncorrected transaction rejects occurring in the G009 reporting system during daily operations. Further, the product management team must rely on contractor-provided, unsupported inventory balances to file maintain asset quantities in the D200A requirements system. Additionally, on-site Defense Contract Management Agency personnel are not required to verify the contractor provided data.

¹ The 'Final D200' quantities are the result of production management team file maintenance performed during the September 2006 computation cycle and based on contractor-provided inventories.

Impact. Accurately file maintaining D200A requirements system end item inventories will improve requirements computations.

Audit Note. We elevated the issue of the G009 reporting system's interface delays, uncorrected transaction rejects, and unsupported inventory balances to the audit control point for possible inclusion in the Air Force-wide Summary Report of Audit.

Recommendation A.1. The 984th Combat Sustainment Group Commander should require the landing gear product management team to periodically reconcile actual contractor inventory balances to D200A requirements system inventory balances.

Management Comments. The 84th Combat Sustainment Wing Commander nonconcurred with the audit result but implemented an alternative corrective action for Recommendation A.1, and stated:

- **Audit Result.** "We disagree with the basis of the audit result based on the following logic. The audit process included conducting an inventory count on 17 October 2006, and reconciling the results to the contractor's inventory system on the same day. The inventory counts matched the system balances in most cases and all variances were reconciled to contractor records. The audit process then utilized contractor provided data (receipts and shipments) to project inventory balances as of 30 September 2006, and those balances were then compared to contractor data manually provided directly to the item manager for file maintenance in the requirements computation. The auditors did not conduct audit tests to validate the accuracy of the receipts and shipment data used to come to their conclusions. The G009 System is a batch processing system that is not run at the end of the quarter, so we are required to manually obtain contractor inventory balances at the end of each quarter to file maintain in the requirements system. For example, the September 2006 G009 balances overlaid to the requirements system were from the 26 September 2006 batch file. In the past, we have provided the contractor a G009 inventory report and they have identified timing differences which the item manager file maintained. There is a chance that the contractor made some errors in identifying the timing differences to the item manager."
- **Recommendation A.1.** "Since the 17 October 2006 inventory showed the contractor's inventory system is reliable, we have requested the contractor to provide end-of-quarter inventory reports from their system to file maintain in the requirements computation. Further, we will continue to conduct periodic inventory counts to validate the accuracy of the contractor's inventory system." (Closed)

Evaluation of Management Comments. Although management nonconcurred with this Tab's audit results, they took action which we believe will correct the deficiency; therefore, this issue does not warrant elevation for resolution. The G009 reporting system is a batch processing system that is not run at the end of the quarter, which is why shipment and receipt data were used

to reconcile inventories back to the G009 system quantities. Although tests were not performed to confirm the reliability of the contractor-provided data, we believe audit tests were adequate to support the reported conclusions.

BACKGROUND

Guidance systems for the Peacekeeper and Minuteman intercontinental ballistic missile are maintained by an Air Force contractor. The Peacekeeper missile was deactivated in October 2005, but the Minuteman system is scheduled to be used through 2020. The contractor has been receiving and storing sensitive Government owned material awaiting demilitarization and disposal in a controlled area. The material is stored until funds become available for demilitarization and subsequent disposal. Demilitarization is the process of rendering an item useless to prevent inadvertent technology transfers and use against US interests.

AUDIT RESULTS 2 – CONTROL

Condition. The guidance system team could improve controls over sensitive Government owned material² awaiting demilitarization and disposal. Specifically, 20 (95 percent) of 21 sampled line items were not properly accounted for within G009 or another accounting system. Additionally, management did not adequately reconcile assets to maintain reasonable internal controls. To illustrate, due to the 1.1 million items contained in the Appendix B, management only reconciles high dollar value end items with frequent movement.

Cause. The Guidance System Program Manager stated this occurred because the specifications of this Contract Logistics Support contract, allow material awaiting demilitarization and disposal to be excluded from the G009 reporting system. Obsolete and excess items without a future demand in D200, may be omitted from G009 reporting; however, sensitive material should be periodically inventoried and reconciled with accounting records to maintain asset control until demilitarization and disposal.

Impact. Improving controls over sensitive Government owned material totaling 1.1 million items and valued at over \$404.9 million, may prevent inadvertent technology transfers, unintentional use by hostile parties, and reduce the risk for fraud, waste, and abuse.

Audit Note. We elevated the issue of excluding Government owned material from the G009 reporting system to the audit control point for possible inclusion in the related Air Force Summary Report of Audit.

Recommendations. The Guidance System Program Manager should:

- Recommendation B.1. Identify the current asset balances of all Government owned material awaiting demilitarization and disposal at the contractor's facility. Specifically,

² This material mainly consisted of parts related to the guidance systems and included assets that were part of the end item as well as additional floating stock items; which the contractor had available to support the repair line when sub-assembly repair times exceeded the end item repair time.

obtain a current and complete physical inventory of Government owned material and reconcile the inventory with the contract's Appendix B accountable records.

- Recommendation B.2. Annually reconcile all Government owned material awaiting demilitarization and disposal with physical inventory counts. Any identified differences should be investigated and results of the investigation retained until all material has been disposed.

Management Comments. The 526th Intercontinental Ballistic Missile Systems Wing Commander concurred with the audit results, implemented alternative corrective action for Recommendations B.1 and B.2, and stated:

- Audit Results. “All Government owned material awaiting demilitarization and disposal is isolated in a controlled facility and/or classified storage. Accountability of government property is controlled through a government approved contractor property control system (OASIS and CAMS) and the contract Appendix B. The program office has the latest annual update to the Appendix B and can receive information from OASIS at any time. Further, there is an on-site DCMA Property Administrator whose duties include the on-site evaluation of property and oversight of the contractor's property control system. In addition, the property administrator monitors all demilitarization and is one of two personnel that accompanies and witnesses the total destruction of classified material. Upon completion of demilitarization, the contractor provides the government with a spreadsheet of the items demilitarized by serial number. However, the government did not have visibility of “Work in Process (WIP)” and will ask the contractor to provide inventory balances of WIP awaiting demilitarization and disposal.”
- Recommendation B.1. “The program office will ask the contractor to conduct a physical inventory and reconciliation of government owned material, including WIP, awaiting demilitarization and disposal. This information will be included with the annual updates of the Appendix B. Estimated completion date is 31 May 2007.
- Recommendation B.2. “The program office will ask the contractor to conduct an annual physical inventory and reconciliation of government owned material awaiting demilitarization and disposal. Any observed discrepancies will be investigated and results retained until all material has been disposed. The government will request this be in conjunction with the annual update of Appendix B. Estimated completion date is 31 May 2007 and every October thereafter.”

Evaluation of Management Comments. Management agreed with Tab B's audit results but proposed corrective actions alternative to the ones recommended in the report. Management's proposed alternative actions should correct the problem.

CRITERIA USED. The following criteria were used to evaluate assets at contractor facilities:

- Air Force Materiel Command Instruction 21-113, *Contract Maintenance Program for Depot Maintenance Activity Group (DMAG)*, 2 June 2005, describes policies and operating procedures, and assigns responsibility for the Depot Maintenance Activity Group at Air Force Materiel Command field units.
- Air Force Materiel Command Instruction 21-134, Volume 2, *Government Furnished Material and End Item Transaction Reporting System (G009) – Reporting Procedures for Contractors*, 19 May 2000, gives policy and procedures for the implementation and management of the Air Force G009 reporting system within Air Force Materiel Command.
- Air Force Materiel Command Manual 23-1, *Requirements for Secondary Items (D200A, D200N)*, 16 March 2005, prescribes guidance and procedural instructions for computing XD1, XD2, XB3, and XF3 secondary item requirements.

AUDIT SCOPE

Audit Coverage. We reviewed the Secondary Items Requirements Computation System (D200A) reports that included asset reconciliations, stock record account number, and sub-group master computation worksheets; and Government Furnished Material and End Item Transaction Reporting System (G009) reports that included serviceable and unserviceable asset inventory reports and shipment tracking documentation. Further, we reviewed contract F42610-99-D0006 appendices A and B. The various reports and documents were from the time period of 20 October 1999 through 20 December 2006. We performed this audit from 3 October 2006 through 6 February 2007 and provided the draft report to management on 29 March 2007. Details of our specific audit tests follow:

- Book-to-Floor Inventories. To evaluate the management and accuracy of reported asset inventory balances, we reconciled physical inventories performed at contractor locations with the G009 reporting system and the D200A requirements system balances. We interviewed item managers and production management specialists to research variances between physical counts and recorded balances. Additionally, we reviewed initial and final D200A requirements system balances to determine whether balances were file maintained for the March, June, and September 2006 computation cycles.
- Untracked Assets. To determine the status of assets at the contractor location which were not tracked in the G009 reporting system, we interviewed management about the disposition of assets, inventory reconciliation process, and justification for not maintaining balances in the G009 reporting system. We identified the D200A status, demilitarization and controlled inventory items codes, and status of Defense Contract Management Agency desk audits.

Sampling Methodology. We used the following sampling and computer assisted auditing tools and techniques.

- Book-to-Floor Inventories. The audit control point selected a judgmental sample of national stock numbers based upon the highest item value and budgeted buy and repair requirements from the five contractors with the most inventory line items. The population from which this sample was taken consisted of almost \$3 billion of spare assets being repaired at 252 contractors. The sample for Hill AFB consisted of 43 line items with standard unit prices totaling \$2.2 million.
- Untracked Assets. We selected 21 judgmental sample items from a contractor-provided list of assets maintained at the contractor location but not tracked in the G009 reporting system. The universe consisted of 307 national stock numbers belonging to the Intercontinental Ballistic Missile program at the Ogden Air Logistics Center valued at \$106.9 million. The sample consisted of the 20 highest dollar value stock-listed assets and an additional asset the audit control point included based on recent transaction

activity identified by the contractor. The extended value of the sample was in excess of \$87 million.

- Computer Assisted Auditing Tools and Techniques. We used a nested formula of *Index/Match* functions to lookup data from the auditor book-to-floor inventories based on the national stock number. These formulas also entered data in the appropriate fields for the book-to-floor inventory analysis.

Data Reliability. We relied on computer-processed data contained in the following systems:

- Secondary Items Requirements Computation System (D200A). To establish data reliability and accuracy, we compared output data with manual documents and reviewed outputs for obvious errors. This was accomplished by comparing asset quantities from the requirements system to manual contractor provided inventories and auditor records-to-floor inventories adjusted for transactions occurring between the prior end of month and the inventory date. Based on these tests, we concluded that the data were reliable in meeting the audit objective.
- Government Furnished Material and End Item Transaction Reporting System (G009). To establish data reliability and accuracy, we compared output data with manual documents and reviewed outputs for obvious errors. This was accomplished by comparing asset quantities to manual contractor provided inventories, D200 requirements system initial balances, and auditor records-to-floor inventories adjusted for transactions occurring between the prior end of month and the inventory date. The results of these tests showed an error rate that casts doubt on the data's validity. However, we believe the opinions, conclusions, and recommendations in this report are valid when viewed with other available evidence.
- Contractor inventory systems. We did not conduct tests to confirm the data's reliability because these are contractor owned and operated systems. In our opinion, however, not following that standard had no material effect on the audit results.

Auditing Standards. We conducted this audit in accordance with generally accepted government auditing standards, including such tests of internal controls as considered necessary under the circumstances. Specifically, we obtained an understanding of the transaction and physical accountability controls by comparing system produced beginning and ending asset quantities with floor-to-book inventories and determining whether management had reconciled physical assets with recorded accountability.

Discussion with Responsible Officials. We discussed/coordinated this report with the Ogden Air Logistics Center Staff, 526th Intercontinental Ballistic Missile Systems and 84th Combat Sustainment Wing Commanders' Representatives, and other interested officials. Management was advised this audit was part of an Air Force-wide evaluation, Assets at Contractor Facilities, (Project F2006-FC4000-0433.000). Therefore, selected data not reflected in this report, as well

as data contained herein, may be included in a related Air Force report of audit. Management's formal comments were received on 29 May 2007 and are included in this report.

PRIOR AUDIT COVERAGE

We did not identify any Air Force Audit Agency, Department of Defense Inspector General, or Government Accountability Office reports issued to the Ogden Air Logistics Center within the past 5 years that were related to our specific objectives.

POINTS OF CONTACT

AFAA Hill Area Audit Office
6068 Aspen Avenue, Bldg 1294
Hill AFB, UT 84056-5805

Mr. Gregory C. Carlson, Office Chief
DSN 775-3615
Commercial (801) 775-3615

Mr. Luke Highsmith, Team Chief

Ms. Gerri Baker, Auditor-in-Charge

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PROJECT NUMBER

We accomplished this audit under project number F2006-FC4000-0433.002.

FREEDOM OF INFORMATION ACT

The disclosure/denial authority prescribed in AFD 65-3 will make all decisions relative to the release of this report to the public.