Audit Report

OFFICE OF THE INSPECTOR GENERAL

CHARGES ASSESSED THE ARMY BY THE DEFENSE LOGISTICS AGENCY FOR DEPLOYABLE MEDICAL SYSTEMS

Report No. 95-170

April 12, 1995

Department of Defense

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Acronyms

DDOU	Defense Distribution Depot Ogden
DEPMEDS	Deployable Medical Systems
DLA	Defense Logistics Agency
DPSC	Defense Personnel Support Center

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

April 12, 1995

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Charges Assessed the Army by the Defense Logistics Agency for Deployable Medical Systems (Report No. 95-170)

We are providing this audit report for your review and comments. The audit was requested by the Deputy Assistant Secretary of the Army (Financial Operations). Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Defense Logistics Agency concurred with all recommendations in the draft report. However, we request that it provide additional comments to clarify actions taken to implement Recommendation 4. by June 13, 1995.

The courtesies extended to the audit staff are appreciated. If you have questions on the report, please contact Mr. Charles F. Hoeger, Audit Program Director, or Mr. Terrance Wing, Audit Project Manager, at (215) 737-3881 (DSN 444-3881). The distribution of this report is in Appendix B. The audit team members are listed on the inside back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-170 **April 12, 1995**
(Project No. 4LD-5026)

CHARGES ASSESSED THE ARMY BY THE DEFENSE LOGISTICS AGENCY FOR DEPLOYABLE MEDICAL SYSTEMS

EXECUTIVE SUMMARY

Introduction. We performed this audit in response to a request from the Deputy Assistant Secretary of the Army (Financial Operations). The Deputy Assistant Secretary requested that we evaluate the reasonableness of Defense Logistics Agency charges assessed the Army for the storage and assembly of deployable medical systems. The Defense Logistics Agency charges the Army, a Defense Business Operations Fund customer, for support it provides in procuring deployable medical systems. Army officials asked us to evaluate the controls used to identify and accumulate Defense Logistics Agency costs used to bill the Army for deployable medical systems. Deployable medical systems are standardized modular field hospitals that can be prepositioned in the event of a contingency, national emergency, or war operations. In FY 1994, the Defense Personnel Support Center billed the Army $25 million for acquiring and assembling deployable medical systems.

Objectives. The original audit objective was to evaluate the reasonableness of Defense Logistics Agency charges assessed the Army for the assembly and storage of deployable medical systems. We revised the objective to also evaluate the reasonableness of materiel charges for deployable medical systems and to not evaluate storage costs, because those costs were insignificant. Additionally, we evaluated the effectiveness of applicable internal controls.

Audit Results. The process that the Defense Logistics Agency used to identify, price, accumulate, and bill the Army for deployable medical systems costs required improvement. Additionally, the Defense Personnel Support Center was erroneously charged for the receipt of Army owned deployable medical systems materiel. As a result, the Army was not accurately charged for deployable medical systems, and the Defense Personnel Support Center was overcharged approximately $1.8 million for distribution depot costs. See Part II for details.

The type of problems identified in this audit affect the reasonableness and accuracy of charges to other Defense Business Operations Fund customers, because similar processes are used to accumulate costs and assess charges.

Internal Controls. Internal controls and the implementation of the DoD Internal Management Control Program were not effective to identify material internal control weaknesses associated with charges for deployable medical systems and Defense Personnel Support Center distribution depot expenses. See Part I for the internal controls reviewed, and Part II for the details of the identified weaknesses.

Potential Benefits. Implementing the recommendations should improve the process that the Defense Personnel Support Center uses to charge for deployable medical system costs and enhance the accuracy of distribution depot charges to inventory control points. However, we could not quantify the potential benefits.

Summary of Recommendations. We recommend that the Director, Defense Logistics Agency, establish controls to ensure that depot labor hours, standard hourly labor rates, and the depot overhead rate are accurate and that the Army is charged for all deployable medical system materiel packed in modules; revise procedures used to compute the deployable medical system assembly surcharge; discontinue the surcharge on deployable medical system materiel not managed by the Defense Personnel Support Center; and revise procedures to bill the owner of materiel, not the inventory manager, for receipts and issues of materiel.

Management Comments. The Defense Logistics Agency concurred with the finding and all recommendations. Regarding the recommendation to establish procedures to ensure that distribution depots charge the owner of materiel, not the inventory manager, for receipts and issues of materiel, the Defense Logistics Agency stated that in October 1994 the Defense Distribution Depot Ogden began to charge the Army as the owner of deployable medical system materiel. A discussion of the comments is in Part II, and the complete text of the comments is in Part IV.

Audit Response. We consider the comments from the Defense Logistics Agency to be partially responsive. However, the finding discussed a systemic problem, related not just to the Army and deployable medical system materiel, but also to receipts and issues of other Service owned materiel. The recommended procedures need to be implemented at all distribution depots. Therefore, we request that the Defense Logistics Agency provide additional comments by June 13, 1995.

Table of Contents

Executive Summary i

Part I - Introduction 1

Background 2
Objectives 2
Scope and Methodology 3
Internal Controls 3
Prior Audits and Other Reviews 4
Other Matters of Interest 4

Part II - Finding and Recommendations 7

Deployable Medical Systems Charges 8

Part III - Additional Information 15

Appendix A. Organizations Visited or Contacted 16
Appendix B. Report Distribution 17

Part IV - Management Comments 19

Defense Logistics Agency 20

This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

The audit was requested by the Deputy Assistant Secretary of the Army (Financial Operations). The Deputy Assistant Secretary requested an evaluation of the reasonableness of the Defense Logistics Agency (DLA) charges to the Army for the storage and assembly of deployable medical systems (DEPMEDS). DLA charges the Army, a Defense Business Operations Fund customer, for support it provides to acquire and assemble DEPMEDS. Army officials told us they were not aware of any specific problems with the reasonableness of past DLA charges. They asked that we evaluate the controls used to identify and accumulate costs for billing the Army to ensure that the charges were appropriate and reasonable, rather than provide an estimate of any past overcharges or undercharges for DEPMEDS.

DEPMEDS are standardized modular field hospitals used by the Military Departments that can be prepositioned in the event of a contingency, national emergency, or war operations. Requisitions for DEPMEDS are sent to the Defense Personnel Support Center (DPSC), a DLA inventory control point. DPSC acquires the materiel needed to assemble DEPMEDS, and DLA distribution depots assemble and store DEPMEDS. Distribution depots charge DPSC to assemble DEPMEDS, and DPSC bills the Army the standard price of DEPMEDS materiel plus surcharges to recoup costs incurred (materiel, labor, and overhead) to acquire and assemble DEPMEDS. DLA distribution depots charge the Army directly for the storage of DEPMEDS.

About 50 different DEPMEDS assemblies exist, including modules for intensive care units, laboratories, and operating rooms. Fielding of DEPMEDS started in FY 1987 and is scheduled to end in FY 1995. After fielding, the Army will incur additional costs to upgrade and maintain existing DEPMEDS modules. From October 1983 through September 1994, Army funding for DEPMEDS totaled about $514 million. The Army estimates that from FY 1995 through FY 1999 it will incur costs of $28.2 million for DEPMEDS.

Objectives

The original audit objective was to evaluate the reasonableness of DLA charges assessed the Army for the assembly and storage of DEPMEDS. We revised the objective to also evaluate the reasonableness of materiel charges for DEPMEDS and to not evaluate storage costs, because these costs were insignificant. Additionally, we evaluated the effectiveness of applicable internal controls.

Scope and Methodology

We evaluated policies and procedures DLA used to identify, accumulate, and bill the Army for DEPMEDS. We did not evaluate depot charges to the Army for the storage of DEPMEDS, because the charges were not significant. We also did not evaluate cost data obtained from the Defense Distribution Depot Susquehanna, Pennsylvania. We focused our audit efforts at the Defense Distribution Depot Ogden, Utah (DDOU), and DPSC. At DDOU, we examined DEPMEDS assembly cost data provided to DPSC, packing lists, receipt and issue transactions, and time and attendance records. At DPSC, we examined DEPMEDS billings and surcharge calculations. The dates of most of the transactions examined ranged from January 1993 to August 1994. Additionally, we interviewed Army, DDOU, and DPSC personnel. We reviewed DEPMEDS billings generated by the DPSC DEPMEDS Automated Information System and, except as discussed in Part II, generally found the data reliable. However, we made no independent assessment of the general and application controls of the system. We did not use statistical sampling procedures to conduct this audit. We used judgmental samples to test the processes used to charge the Army for DEPMEDS.

We performed this financial related audit from April through October 1994 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of internal controls as considered necessary. Appendix A lists the organizations visited or contacted during the audit.

Internal Controls

Internal Controls Reviewed. We evaluated the adequacy of procedures DLA used to charge the Army for DEPMEDS. Specifically, we evaluated the controls to ensure that DEPMEDS costs were properly identified, priced, accumulated, and billed to the Army. We also reviewed the portion of the DoD Internal Management Control Program applicable to the DEPMEDS program.

Adequacy of Internal Controls. The audit disclosed material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. We considered the weaknesses material, because the problems identified in the processes we examined affect not only the accuracy of DLA charges for DEPMEDS, but also the accuracy of charges to other Defense Business Operations Fund customers. Internal controls were not

adequate to ensure that DEPMEDS costs charged to the Army were accurate. Additionally, internal controls were not in place to ensure that the Army was billed for all DEPMEDS materiel packed in the modules and that DPSC was not billed for depot costs related to Army owned materiel. Recommendations 1., 2., 3., and 4., if implemented, should assist in correcting the internal control weaknesses identified. Potential monetary benefits associated with the recommendations were undeterminable because our analysis was not based on statistical sampling techniques and we did not evaluate all charges of the DEPMEDS program. A copy of the final report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense and DLA.

Implementation of the Internal Management Control Program. We assessed the DDOU and DPSC implementation of the DoD Internal Management Control Program as it applied to the DEPMEDS program. Implementation was not effective because although management at DDOU identified the DEPMEDS program as an assessable unit, they did not evaluate the accuracy of DEPMEDS assembly costs provided to DPSC, and management at DPSC did not identify the DEPMEDS program as an assessable unit and performed no evaluations.

Prior Audits And Other Reviews

No prior audits or other reviews have evaluated the reasonableness of DLA charges to the Army for the acquisition and assembly of DEPMEDS units.

Other Matters of Interest

Under the Defense Business Operations Fund, distribution depots charge inventory control points a standard rate for depot receipts and issues of materiel they manage. Those costs are passed on to the customers in the surcharge added to materiel costs when requisitions are filled by inventory control points.

The DPSC medical directorate, in its FYs 1994 and 1995 business plans submitted to DLA, questioned the practice of distribution depots charging the full standard rate for intradepot issues of DEPMEDS materiel from the depot storage area to the depot DEPMEDS assembly area. The depots charged DPSC $29 per line for each issue of stock to recover the depots' costs for expenses such as labor, packing, and transportation. The medical directorate believed that it should not be charged the full rate, because the depots' packing and

transportation costs (from one depot building to another) for issuing DEPMEDS materiel is minimal. We agree that DEPMEDS intradepot issues do not warrant the same charge as an item being packed and transported greater distances. In FY 1994, the DPSC medical directorate was charged about $1.2 million for approximately 40,500 intradepot issues of DEPMEDS materiel.

DLA is aware of the DPSC concerns and in FY 1996 plans to have a more discrete pricing policy for DEPMEDS. Because management is addressing this issue, we are not making a separate recommendation in this report.

Part II - Finding and Recommendations

DEPMEDS Charges

The process that the Defense Logistics Agency used to identify, price, accumulate, and bill the Army for DEPMEDS required improvement. Additionally, DPSC was erroneously charged for the receipt of Army owned DEPMEDS materiel. The conditions occurred because internal controls did not ensure that depot labor hours, hourly labor rates, and the overhead rate were accurate, and that the Army was properly charged for all DEPMEDS materiel packed in modules. Additionally, DPSC procedures used to compute surcharges were flawed, and due to system constraints, the Defense Distribution Depot Ogden, Utah, did not properly identify the Army as the owner of materiel received into the depot. As a result, the Army was not properly charged for DEPMEDS costs, and DPSC was overcharged $1.8 million for distribution depot costs. The type of problems identified in this audit would affect the reasonableness and accuracy of charges to other Defense Business Operations Fund customers, because similar processes are used to identify and accumulate costs and assess charges.

Background

The DPSC medical directorate manages the DPSC DEPMEDS program. The cost of a DEPMEDS module generally includes the standard price of the materiel in the module and an assembly surcharge. The standard price includes the acquisition cost of the materiel and a surcharge for DPSC to recoup its costs (labor, depot costs related to receipts and issues, overhead, etc.) for procuring DEPMEDS materiel. The assembly surcharge, 13.1 percent in FY 1994, recoups costs that DPSC paid to DLA distribution depots for DEPMEDS assembly expenses. In April 1994, DPSC included an additional 5-percent surcharge in its DEPMEDS billings for costs incurred in procuring DEPMEDS materiel not managed by DPSC (General Services Administration, other DLA inventory control points, etc.).

DPSC calculates the assembly surcharge based on input from the distribution depots that assemble DEPMEDS. Before each fiscal year, the depots, based on actual current year costs and planned workload, provide DPSC an estimate of the assembly costs that DPSC will have to reimburse the depots in the upcoming fiscal year.

DEPMEDS Charges

The process that DLA used to identify, price, accumulate, and bill the Army for DEPMEDS required improvement. In addition, DDOU erroneously charged DPSC for the receipt of Army owned materiel. Specifically,

o DDOU labor hours used to estimate assembly costs and compute the DPSC assembly surcharge did not agree with the hours recorded on the DDOU daily time and attendance reports.

o The standard hourly rates that DDOU used to determine labor costs and estimate assembly costs exceeded the average of the actual hourly rates.

o No documentation supported the DDOU calculation of its overhead rate included in the estimated assembly costs.

o The quantity of DEPMEDS materiel packed in DEPMEDS modules by DDOU did not agree with the quantity billed.

o The surcharge computed by DPSC for DEPMEDS hospital modules was understated.

o The 5-percent surcharge added to DEPMEDS materiel managed by an organization other than DPSC was not appropriate.

o DPSC was erroneously charged distribution depot costs for Army owned materiel received into the depot.

As a result of the conditions identified, the Army was not properly charged for DEPMEDS, and DLA was overcharged for distribution depot expenses.

Depot Labor Hours. The labor hours DDOU used to estimate assembly costs and provided to DPSC to compute the assembly surcharge were not supported by DDOU daily time and attendance reports. We attribute this to a lack of controls to reconcile the labor hours reported with time and attendance records. The labor hours used to estimate assembly costs were taken from computerized monthly job order status reports. Manual time and attendance logs that show the daily time charges for each employee are used to generate the job order status report.

Our review of 5 months (February 1993 through May 1993 and September 1993) of DDOU labor hours for the Assembly Branch and the Industrial Section of the Stock Maintenance Division showed that the job order status report was overstated by 492 hours. The daily time and attendance reports had 15,659 hours recorded, while the job order status reports had

16,151 hours recorded for the same period. Responsible depot personnel were able to reconcile 68 of the 492 hours (personnel from other sections charged time to DEPMEDS work); however, neither we nor depot personnel could identify the reason for the remaining 424-hour difference. Overstating labor hours by 424 hours would overstate labor costs by approximately $6,000. If the hours recorded on the job order status reports are not validated or accurate, the assembly surcharge will not be correct and will result in either overbillings or underbillings.

Standard Hourly Rates. The standard hourly rates that DDOU used to compute DEPMEDS assembly labor costs exceeded the average of the actual hourly rates. This occurred because there were no controls to ensure that the standard hourly rates represented actual average hourly rates. We compared the standard hourly rates with the actual hourly rates of the 108 individuals assigned to the depot assembly branch and the depot industrial section and determined that the standard hourly rates for the branch and section were overstated. The standard hourly rate used for the assembly branch was $12.04 an hour. The actual hourly rate averaged $11.18 an hour. For the industrial section, the standard rate was $15.50 an hour, while the actual average rate was $14.30 an hour. Because labor hours worked are multiplied by the standard hourly rates to compute assembly costs, any inaccuracies in the hourly rate will result in an inaccurate assembly surcharge.

Overhead Rate. We could not evaluate the reasonableness of the DDOU overhead rate included in the estimated assembly cost and in the DPSC assembly surcharge because no documentation supported the overhead rate calculation. During FY 1994, the DDOU overhead rate was 150 percent of labor costs. The overhead rate included general and administrative costs. The DDOU overhead rate was significantly higher than the 101-percent overhead rate used by the Defense Distribution Depot Susquehanna, Pennsylvania. We attempted to determine the reason for the difference, but were unsuccessful because documentation supporting the computation of the DDOU overhead rate was not available. Depot personnel informed us that the individuals responsible for calculating the rate were no longer employed by DDOU. The DDOU overhead rate decreased to 61.2 percent in FY 1995.

Materiel Packed in DEPMEDS. The quantity of DEPMEDS materiel that DDOU packed in DEPMEDS did not agree with the quantity that DPSC billed. The discrepancy occurred because no controls were in effect to reconcile the quantity that DPSC billed with the quantity that DDOU packed. We judgmentally reviewed eight final DEPMEDS bills from DPSC to the Army from July through October 1993. The final DPSC bill listed all items packed (sutures, needles, surgical equipment, etc.) by national stock number for which the Army was being billed. Our comparison of the national stock numbers listed on the final bills with the DDOU packing slips showed that in all eight bills DDOU packed more materiel than what DPSC billed the Army. For

example, on 1 bill DPSC charged the Army $68,874 for 998 items. The depot actually packed 1,088 items, valued at $93,380. For the eight bills we reviewed, DPSC billed the Army a total of $464,605, while the DDOU packed materiel valued at $584,515 ($119,910 more than what the Army was billed). Due to the nonavailability of documentation from DDOU to DPSC regarding packing information, we were unable to determine the specific cause for the discrepancies. However, timely reconciliation of the billings and packing slips would identify the specific cause and needed corrective action.

Assembly Surcharge. The surcharge computed by DPSC for DEPMEDS hospital modules was understated. This occurred because the process used to compute the surcharge was flawed. For FY 1994, estimated assembly costs provided by DDOU to DPSC showed that the surcharge computed by DPSC for DEPMEDS hospital modules should be 19.8 percent. Instead of using the 19.8-percent surcharge, DPSC combined the DEPMEDS surcharge rate with data provided by the Defense Distribution Depot Susquehanna, Pennsylvania, for assembling non-DEPMEDS equipment (sick call sets, search and rescue sets, etc.) and computed a weighted surcharge average of 13.1 percent. The estimated cost data provided by the Susquehanna depot showed that the surcharge rate computed by DPSC for non-DEPMEDS equipment should be 4.6 percent. As a result, DPSC customers charged 13.1 percent for non-DEPMEDS hospital assemblies subsidized expenses for DEPMEDS hospital assemblies.

DPSC personnel informed us that they used the weighted average rate because it simplified the accounting functions, one surcharge rate instead of two. If the rate of 19.8 percent for DEPMEDS hospitals had been used to charge the Army, the total cost to the Army would have been $1.5 million more than what was actually charged. During FY 1994, DPSC billed the Army $25 million for DEPMEDS hospital modules. The $25 million represented the value of the materiel packed by the depot and the 13.1 percent surcharge. Had the actual DEPMEDS surcharge been used, the Army would have been billed $26.2 million (value of materiel packed by the depot and the 19.8 percent surcharge).

DPSC Surcharge. The 5-percent surcharge added to DEPMEDS materiel managed by an organization other than DPSC was not appropriate. That occurred because DPSC procedures to recoup costs were flawed. When DPSC receives a requisition to procure a hospital module, DPSC procures the items needed to assemble the module. Some of the items included in the module are not managed by DPSC, and DPSC must pass the requisitions for the materiel to the appropriate item manager.

In April 1994, DPSC started adding a 5-percent surcharge to the standard price of DEPMEDS materiel not managed by its medical directorate. DPSC personnel believed that the surcharge was required to reimburse DPSC for the time expended in obtaining and tracking the materiel to ensure that the materiel was available at the depot when the module was being assembled. The surcharge was inappropriate. DPSC labor costs were already included in the standard price of medical materiel. The additional surcharge resulted in the Army being overcharged an estimated $15,000 from April through September 1994.

Charges for Army Owned Materiel. DDOU erroneously charged DPSC for Army owned materiel received into the depot. That occurred because the depot system used to process receipts and issues identified the DoD manager of the materiel, not the owner of the materiel, as the organization to bill. As a result, DPSC was erroneously charged for receipts of Army owned materiel. As part of the Army downsizing and the returning of hospital modules from Southwest Asia, the Army directed DDOU to disassemble a number of hospital modules. The Army paid for the work with a Military Interdepartmental Purchase Request directly reimbursing the depot for the disassembly. The depot was to disassemble and inspect the materiel in the module, and put the serviceable materiel into inventory, coded as Army owned materiel. To record the receipt transaction and put the materiel on accountable inventory records, the depot processed a receipt transaction to DPSC, the DoD integrated manager of the materiel. As a result, DPSC was charged the cost to process the receipt ($29 per receipt), even though the materiel was Army owned and the work was directed by the Army. For the 12-month period ending September 1993, DDOU processed 63,737 Army directed receipt and disassembly transactions. Those transactions equated to approximately $1.8 million being erroneously charged to DPSC. The inappropriate charge inflated DPSC costs and its surcharge subsequently billed to customers for medical materiel.

The type of problems identified in this audit would also affect the reasonableness and accuracy of charges to other Defense Business Operations Fund customers, because similar processes are used to accumulate costs and assess charges.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Logistics Agency:

1. Establish controls to provide that:

a. Labor hours on the depot job order status reports are reconciled with time and attendance reports.

b. Standard hourly rates used to estimate deployable medical system assembly costs are representative of actual hourly rates.

c. Documentation is maintained to support depot overhead rates.

d. Deployable medical system final bills are reconciled against depot packing lists.

2. Compute separate assembly surcharges for deployable medical system hospital modules and nonhospital assemblies.

3. Discontinue the 5-percent surcharge on deployable medical system materiel not managed by the Defense Personnel Support Center.

4. Establish procedures to ensure that distribution depots charge the owner of materiel, not the inventory manager, for receipts and issues of materiel.

Management Comments. The DLA concurred with all recommendations. Regarding Recommendations 1., 2., and 3., DLA stated that actions have been or will be taken to ensure that labor hours, hourly labor rates, overhead rates, surcharge rates, and DEPMEDS billings are accurate and properly supported. Regarding Recommendation 4., DLA stated that in October 1994, the Defense Distribution Depot Ogden began to charge the Army as the owner of DEPMEDS materiel for receipts and issues of materiel.

Audit Response. The comments from DLA and actions taken or planned are generally responsive. However, comments on Recommendation 4. require further clarification. The finding discussed a systemic problem, related not just to the Army and DEPMEDS materiel, but also to receipts and issues of other Service owned materiel. The recommended procedures need to be implemented at all distribution depots to ensure that receipt and issue charges are proper. Therefore, we request that DLA provide additional comments in response to the final report.

Part III - Additional Information

Appendix A. Organizations Visited or Contacted

Department of the Army

Comptroller, Department of the Army, Arlington, VA
U.S. Army Medical Materiel Agency, Ft. Detrick, MD

Department of the Navy

Fleet Hospital Support Office, Alameda, CA

Defense Organizations

Defense Logistics Agency, Alexandria, VA
Defense Personnel Support Center, Philadelphia, PA
Defense Distribution Region East, New Cumberland, PA
  Defense Distribution Depot Susquehanna, PA
    Mechanicsburg Facility, PA
Defense Distribution Region West, Stockton, CA
  Defense Distribution Depot Ogden, UT
    Ogden Facility, UT

Appendix B. Report Distribution

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Assistant to the Secretary of Defense (Public Affairs)

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Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, U.S. Army Medical Materiel Agency

Department of the Navy

Assistant Secretary of the Navy (Financial Management)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Commander, Defense Personnel Support Center
Commander, Defense Distribution Region East
  Commander, Defense Distribution Depot Susquehanna
Commander, Defense Distribution Region West
  Commander, Defense Distribution Depot Ogden
Director, Defense Medical Standardization Board
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

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Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Part IV - Management Comments

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

24 FEB 1996

IN REPLY
REFER TO DDAI

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: OIG Draft Report, "*Charges Assessed the Army by the Defense Logistics Agency for Deployable Medical Systems*," (**Project No. 4LD-5026**)

This is in response to your 16 December 1995 request.

Encl

JACQUELINE G. BRYANT
Chief, Internal Review

cc:
FO

FORMAT *1* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

FINDING: DEPMEDS CHARGES. The process that the Defense Logistics Agency used to identify, price, accumulate, and bill the Army for DEPMEDS required improvement. Additionally, DPSC was erroneously charged for the receipt of Army owned DEPMEDS materiel. The conditions occurred because internal controls did not ensure that depot labor hours, hourly labor rates, and the overhead rate were accurate, and that the Army was properly charged for all DEPMEDS materiel packed in modules. Additionally, DPSC procedures used to compute surcharges were flawed, and due to system constraints, the Defense Distribution Depot Ogden, Utah, did not properly identify the Army as the owner of materiel received into the depot. As a result, the Army was not properly charged for DEPMEDS costs, and DPSC was overcharged $1.8 million or distribution depot costs. The type of problems identified in this audit would affect the reasonableness and accuracy of charges to other Defense Business Operations Fund customers, because similar processes are used to identify and accumulate costs and assess charges.

DLA COMMENTS: *We concur*. Please refer to specific recommendations for corrective actions.

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER: Terrie Stephens, FOXS, x46222, 17 Feb 95
PSE REVIEW/APPROVAL: Jim O'Laughlin, FOXS, x46100, 17 Feb 95
COORDINATION: Eileen Sanchez, FOE, x46220, 22 Feb 95
J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
LaVaeda Coulter, DDAI, 22 Feb 95
[illegible], DDAT, 23 Feb

DLA APPROVAL:

23 FEB 1995

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

FORMAT *2* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

RECOMMENDATION 1.a: We recommend that the Director, Defense Logistics Agency establish controls to ensure that labor hours on the depot job order status reports are reconciled with time and attendance reports.

DLA COMMENTS: *We concur.* DDOU will provide oversight and reconciliation of labor hours and job order costs by sampling 15 job orders per month. This internal control procedure was initiated in February 95.

DISPOSITION:
Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER: Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL: Jim O'Laughlin, FOXS, x46100
COORDINATION: Eileen Sanchez, FOE, x46220, 22 Feb 95
J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
LaVaeda Coulter, DDAI, 22 Feb 95
[illegible], DDAT, 23 Feb 95

DLA APPROVAL:

[illegible] 1995

[illegible] Director

FORMAT *3* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

RECOMMENDATION 1.b: We recommend that the Director, Defense Logistics Agency establish controls to ensure that standard hourly rates used to estimate deployable medical system assembly costs are representative of actual rates.

DLA COMMENTS: *We concur.* In February, DDOU began using the actual average hourly rate rather than the standard to estimate DEPMEDS assembly costs. These figures are reported by depot assembly branch to DPSC on a quarterly basis.

DISPOSITION:
Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER: Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL: Jim O'Laughlin, FOXS, x46100
COORDINATION: Eileen Sanchez, FOE, x46220, 22 Feb 95
J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
LaVaeda Coulter, DDAI, 22 Feb 95
, DDAI, 23 Feb 95

DLA APPROVAL:

23 FEB 1995

FORMAT *4* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS
(PROJECT NO. 4LD-5026)

RECOMMENDATION 1.c: We recommend that the Director, Defense Logistics Agency establish controls to ensure that documentation is maintained to support depot overhead rates.

DLA COMMENTS: *We concur.* DLA issued the FY 95 pricing guidance to the DLA Distribution Regions **(memo dated 6 Jan 95)**. This guidance gives the Region Commanders latitude in establishing individual/unique overhead rates for cost reimbursable customers. The overhead costs are recovered using a standard algorithm. There is no deviation.

DISPOSITION:
Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER: Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL: Jim O'Laughlin, FOXS, x46100
COORDINATION: Eileen Sanchez, FOE, x46220, 22 Feb 95
J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
LaVaeda Coulter, DDAI, 22 Feb 95
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DLA APPROVAL:

23 FEB 1995

[signature]

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

FORMAT *5* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

RECOMMENDATION 1.d: We recommend that the Director, Defense Logistics Agency establish controls to ensure that deployable medical system final bills are reconciled against depot packing lists.

DLA COMMENTS: *We concur.* DPSC initiated a systems change request that will allow the deployable medical system final bills to be reconciled against depot packing lists. The projected programming completion date is 30 Sep 95.

DISPOSITION:
Action is ongoing. Estimated Completion Date: **30 Sep 95**

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER: Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL: Jim O'Laughlin, FOXS, x46100
COORDINATION: Eileen Sanchez, FOE, x46220, 22 Feb 95
J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
LaVaeda Coulter, DDAI, 22 Feb 95
JB, DDAI, 23 Feb 95

DLA APPROVAL:

FORMAT *6* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

RECOMMENDATION 2: We recommend that the Director, Defense Logistics Agency compute separate assembly surcharges for deployable medical system materiel not managed by the Defense Personnel Support Center.

DLA COMMENTS: *We concur.* DPSC has changed the DEPMEDS file to allow the billing of each assembly with its own build cost. This change will be implemented in the annual pricing update and will be effective in FY 96.

DISPOSITION:
Action is ongoing. Estimated Completion Date: **1 Oct 95**

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER: Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL: Jim O'Laughlin, FOXS, x46100
COORDINATION: Eileen Sanchez, FOE, x46220, 22 Feb 95
J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
LaVaeda Coulter, DDAI, 22 Feb 95
JM, DDAI, 23 Feb 95

DLA APPROVAL:

FORMAT 7 OF 8

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

RECOMMENDATION 3: We recommend that the Director, Defense Logistics Agency discontinue the 5 percent surcharge on deployable medical system materiel not managed by the Defense Personnel Support Center.

DLA COMMENTS: *We concur.* Because labor costs are being recovered in the standard price of medical materiel, DPSC will remove the 5 percent surcharge on multi-managed items in FY 96.

DISPOSITION:
Action is ongoing. Estimated Completion Date: **1 Oct 95**

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER:	Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL:	Jim O'Laughlin, FOXS, x46100
COORDINATION:	Eileen Sanchez, FOE, x46220, 22 Feb 95
	J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
	LaVaeda Coulter, DDAI, 22 Feb 95

JA, DDAI, 23 Feb 95

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

FORMAT *8* OF *8*

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: CHARGES ASSESSED THE ARMY BY DLA FOR DEPLOYABLE MEDICAL SYSTEMS **(PROJECT NO. 4LD-5026)**

RECOMMENDATION 4: We recommend that the Director, Defense Logistics Agency establish procedures to ensure that distribution depots charge the owner of materiel, not the inventory manager, for receipts and issues of materiel.

DLA COMMENTS: *We concur.* Beginning in October 1994, DDOU began to charge the Army as the owner of the DEPMEDS materiel for the receipts and issues of materiel. DDOU also began monthly reporting to DDRW the disassembly items owned by the Army and processed by DDOU.

DISPOSITION:
Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESS:
Concur; however, weakness is not considered materiel.

ACTION OFFICER:	Terrie Stephens, FOXS, x46222
PSE REVIEW/APPROVAL:	Jim O'Laughlin, FOXS, x46100
COORDINATION:	Eileen Sanchez, FOE, x46220, 22 Feb 95
	J. D. McCarthy, CAPT, SC, USN, Comptroller, 21 Feb 95
	LaVaeda Coulter, DDAI, 22 Feb 95
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DLA APPROVAL:

23 FEB 1995

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Principal Deputy Director

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