INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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August 14, 1990

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (FORCE MANAGEMENT AND PERSONNEL)
COMPTROLLER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Use of ROTC Commutation Funds (Report No. 90-098)

This is our final report on the Use of Reserve Officer Training Corps (ROTC) Commutation Funds. Comments on a draft of this report were considered in preparing this final report. The matters covered in this report were examined during our audit of commutation funds at Virginia Polytechnic Institute and State University (VPI). The Contract Management Directorate made the audit from October 1989 through February 1990 at the request of the Chief of Naval Education and Training. The objective of the audit work covered by this report was to determine whether DoD regulations concerning the use of commutation funds were adequate. This objective was an expansion of our originally announced audit objectives which were to determine whether VPI properly managed commutation funds, provided by DoD, to support the ROTC and to determine if VPI had implemented adequate internal controls to ensure compliance with DoD regulations.

This report addresses the adequacy of DoD regulations. We will address VPI's management of, and internal controls over, the use of DoD funds in a separate report. We reviewed VPI expenditures as claimed in its Annual Reports on Uniform Commutation Funds for the years ended June 30, 1982 through June 30, 1989. During this period, VPI received over $1.59 million in gross entitlements of DoD commutation funds from the Army, Navy, and Air Force. For the year ended June 30, 1989, DoD provided all Army, Navy and Air Force ROTC units a total of $4.55 million in commutation fund entitlements. The results of the audit are summarized in the following paragraphs, and the details and audit recommendations are in Part II of this report.

Charges applied against the uniform commutation fund by VPI may have been inappropriate. However, both the DoD policy and the related internal controls were inadequate to enable us to determine what charges were correct. Establishment of adequate

internal controls, including periodic audit, at the diverse ROTC locations would be very expensive. Also, DoD was paying an additional $1.8 million per year to provide distinctive uniforms, based on the school's choice, to students in some ROTC units. We recommended that the Assistant Secretary of Defense (Force Management and Personnel) provide commutation funds to all ROTC units in the form of a flat-rate subsidy based on the cost of a regular issue military uniform. This would reduce management oversight, associated administrative costs, and the detailed cost reporting now required of fund recipients. As an alternative, DoD should clarify DoD Directive 1215.10 to allow for the proper management of DoD funds, direct the Services to publish new implementing regulations consistent with each other and the DoD Directive, and ensure that additional audit and administrative resources are available to adequately administer the current system (page 3).

Internal controls were evaluated as applicable to the stated audit objectives. The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Adequate procedures were not established to ensure compliance with existing policy. Recommendations 1. and 2. in this report, if implemented, will correct the weaknesses. Therefore, a copy of this report will be provided to the senior official responsible for internal controls within the Office of the Secretary of Defense. We have determined that the monetary benefits that can be realized by implementing Recommendation 1 are $9.4 million (Appendix A). We determined that monetary benefits will not be realized by implementing Recommendation 2.

On April 13, 1990, a draft of this report was provided to the Assistant Secretary of Defense (Force Management and Personnel). The Director, Education and Officer Procurement Policy, Office of the Assistant Secretary of Defense (Force Management and Personnel) responded on July 6, 1990 (Appendix B). The Director concurred in all recommendations, choosing to establish a flat-rate subsidy for uniform costs. The subsidy will be based on the cost of regular issue military uniforms. Since we were informed by the Director's staff that the conversion to a flat-rate system is subject to legal review, we have retained the alternative recommendation in the final report. The Director also concurred with the potential monetary savings of $9.4 million. While the Director did not indicate concurrence or nonconcurrence with the internal control weaknesses, we believe the planned action will correct the deficiency.

Subsequent to the issuance of our draft report, we expanded Recommendation 2. Accordingly, we request that the Assistant Secretary of Defense provide comments on Recommendation 2.

Management comments on a draft of this report did not fully comply with the requirements of DoD Directive 7650.3. The Assistant Secretary of Defense (Force Management and Personnel) concurred with all recommendations but did not state planned corrective actions for Recommendation 2. and did not provide estimated dates for completion of planned actions for either Recommendations 1. or 2.; therefore, we ask that he do so in responding to the final report.

The courtesies extended to the audit staff are appreciated. Please contact Mr. Paul J. Granetto, Program Director, at (202) 693-0573 (AUTOVON 223-0573), or Mr. James R. Peterson, Project Manager, at (202) 693-0594 (AUTOVON 223-0594) if you have any questions about this report. Copies of the final report will be distributed to the activities listed in Appendix D. The audit team members are listed in Appendix E.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force

REPORT ON THE AUDIT OF THE
USE OF ROTC COMMUTATION FUNDS

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Prepared by:
Contract Management Directorate
Project No. 0CD-5002

REPORT ON THE AUDIT OF THE USE OF ROTC COMMUTATION FUNDS

PART I - INTRODUCTION

Background

The Military Departments are responsible for providing uniforms to students in the Reserve Officers Training Corps (ROTC). The commutation fund program was established by Public Law 88-647 of 1964 to allow certain schools that maintain senior ROTC units to receive commutation funds instead of Government clothing. In turn, these institutions provide standard or distinctive uniforms and insignia to their ROTC cadets. The Army, Navy, and Air Force provide the commutation entitlements for cadets enrolled in the ROTC program for at least 60 days. As of July 1 of each year, each school is required to complete an "Annual Report on Uniform Commutation Funds" (Annual Report) to the appropriate authority for each Service. The Annual Report reconciles the use of commutation funds from the beginning to ending balances considering expenditures, adjustments, and allowable carryover. Unused funds excluding carryover limitations are to be refunded with the Annual Report. Generally, use of commutation funds is limited to the procurement of standard or distinctive uniforms and to related receipt, storage, issue, and alteration expenses. There are 14 schools, including VPI, that provide distinctive uniforms to their cadets.

This audit was requested on August 17, 1989, by the Chief of Naval Education and Training. The request was made in response to a July 31, 1989, joint memorandum from the three military professors at Virginia Polytechnic Institute and State University (VPI). These professors expressed concern over VPI's management of and accounting for DoD funds.

Objectives and Scope

Our initial objectives were to determine whether VPI properly managed the commutation funds provided by DoD and to determine whether VPI had established adequate internal controls to ensure compliance with DoD Regulations. Basic guidance regarding commutation funds is contained in DoD Directive 1215.10, "Standardized Rates of Subsistence Allowance and Commutation Instead of Uniforms for Members of the Senior Reserve Officers Training Corps," dated February 13, 1986. Each Service has issued individual implementing procedures based on the DoD Directive. We expanded our objectives during the audit to determine the adequacy of the DoD Directive and the consistency of implementing Service regulations. This report addresses the adequacy of DoD guidance and identifies inconsistencies among

Service regulations. We will address VPI's management of, and internal controls over, the use of DoD commutation funds in a separate report.

To accomplish our objectives, we specifically focused on documentation maintained by VPI to support expenditures reported on its Annual Reports. The Annual Reports we reviewed covered the period July 1, 1981, through June 30, 1989. During this period, VPI received gross entitlements of $1.6 million from the Services. We reviewed documentation maintained at VPI and the local ROTC units related to the use of uniform commutation funds. We also reviewed 147 Annual Reports filed by Army, Navy and Air Force ROTC units for the year ended June 30, 1989. These 147 units received commutation fund entitlements of $4.55 million that year.

This economy and efficiency audit was made to determine whether DoD Directive 1215.10 and implementing Service regulations were adequate to ensure the proper use of ROTC commutation funds.

The audit was conducted from October 1989 through February 1990. It was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We, accordingly, included such tests of internal controls as were considered necessary. The activities visited or contacted during the audit are shown in Appendix C.

Internal Controls

We focused on internal controls by determining whether VPI complied with DoD Directive 1215.10 or implemented Service regulations. We also assessed the adequacy of DoD internal controls for ensuring that schools receiving commutation funds were in compliance with applicable regulations. We found that DoD had not implemented any internal controls to ensure compliance with applicable regulations. Implementation of a flat-rate system or detailed DoD regulations will correct this deficiency. This internal control weakness is addressed in Part II of the report.

Prior Audit Coverage

There has been no prior audit coverage of this subject area at VPI during the last 5 years. Additionally, we were told by personnel from the Services' ROTC Headquarters commands that schools receiving commutation funds are not usually audited by DoD.

PART II - FINDING AND RECOMMENDATIONS

Use of Uniform Commutation Funds

FINDING

Virginia Polytechnic Institute and State University (VPI) has applied charges against uniform commutation funds that may not have been appropriate and may have contributed to the mismanagement of DoD funds, and participating institutions were not providing meaningful reports of their management of these funds. This occurred because inconsistencies existed in the terminology used between DoD Directive 1215.10 and Service regulations, which allowed VPI to define allowable charges to its maximum benefit. Internal controls, including DoD oversight, were inadequate. As a result, DoD may be paying too much for uniform commutations.

DISCUSSION OF DETAILS

Background. DoD Directive 1215.10, "Standardized Rates of Subsistence Allowance and Commutation Instead of Uniforms for Members of the Senior Reserve Officers' Training Corps," was issued by the Assistant Secretary of Defense (Force Management and Personnel) to provide guidance for the use of uniform commutation funds. The Directive permits the Services to pay commutation funds not only for the cost of standard or distinctive cadet uniforms, but also for the procurement, receipt, storage, maintenance, and issue of the uniform. The Military Departments develop standard commutation rates annually based on the cost of the latest approved items of clothing that comprise that Service's uniform. Standard commutation rates vary by Service with the Navy rate being the highest. Commutation payments are made to the schools based on the number of students enrolled and in attendence in the Reserve Officer Training Corps (ROTC) program for at least 60 days. Schools that organize and maintain their cadets in a self-contained corps of cadets and meet various other criteria qualify for a special rate of commutation. Although the special rate of commutation is identical for all Military Departments, it is three times the Navy's standard rate.

In addition to the DoD Directive, each Service issued its own implementing regulation. Army guidance is contained in Army Regulation (AR) 700-84, Chapter 10, "Commutation of Uniforms for ROTC Activities," dated November 24, 1986. Chief Naval Education and Training Instruction (CNETINST) 7220.2B, "Commutation in Lieu of Uniforms for Enrolled Members of NROTC at Certain Educational Institutions," dated October 4, 1989, provides guidance to the Navy and the Marine Corps. The Air Force (AF) has two regulations: AF Regulation 45-25, "Air Force ROTC Subsistence Allowance and Rates for Uniform Commutation," dated January 19, 1979, and AFROTC Regulation 170-1, Section C, "Uniform Commutation," dated November 1, 1988. The Services require

schools that receive commutation funds to file an Annual Report, which identifies the commutation funds used during the year, reconciling the beginning and ending balances, and any refund due to DoD.

Educational service agreements between VPI and the Services have been in effect since 1982. These agreements established Army, Navy, and Air Force ROTC units at VPI and, either explicity or implicity, require conformance to applicable Service regulations. VPI qualifies for and receives the special commutation rates.

An Alternative to DoD's Current Management Approach. DoD's interests in the use of uniform commutation funds may be better served by the use of a flat-rate system that would require less management attention by both DoD and the receiving institutions. Rewriting the DoD regulations to be more specific and consistent will produce more accurate expense reports and reduce the chance for the mismanagement of DoD funds. However, it will also require increased oversight to ensure compliance at each school.

Our audit disclosed that DoD's requirements regarding the accounting for, and reporting of, the use of commutation funds were not manageable due to vague and inconsistent DoD guidance. Based on the level of cost reporting implied by the current guidance, and assuming that the guidance is made more specific and consistent, schools such as VPI will have to implement detailed accounting systems to provide the required cost breakdowns. No one in DoD actually used the current cost breakdowns, and we doubt that future cost breakouts will be used.

Our review of the Annual Reports filed for the year ended June 30, 1989, by 12 institutions receiving the special rate of commutation funds from the Army disclosed that 11 institutions did not refund any money to DoD and only 7 had an unexpended balance to carry forward to the next period. The lack of refunds indicates that these schools, all of whom receive the special rate of commutation, spent at least three times the cost of a regular issue Army uniform to outfit their corp of cadets. Further, of the four schools receiving the largest amount in commutation funds, three did not provide the required cost breakout of expenditures. Instead, they reported all expenditures as a single item under either the caption "procurement" or the caption "other." While we did not audit these schools, we believe that the lack of refunds, and the reporting of all expenditures as a single item indicates a problem. It appears that these schools have interpreted the allowable use of commutation funds to their maximum benefit or they do not have adequate accounting systems in place to capture the necessary data.

We could not determine any benefit to be derived from requiring a detailed cost breakout on the use of commutation funds. Further,

other than aiding the continuation of a school's tradition, we could not determine any benefit to be derived by funding schools at the special commutation rate to provide distinctive cadet uniforms to their corp of cadets when Service issue-in-kind uniforms are available at a savings to DoD. We believe that institutions that desire to continue the use of distinctive uniforms for their corp of cadets should provide their own funding for the cost of uniforms above and beyond the standard commutation, which covers the cost of a Service issue-in-kind uniform. Only 5 of the 126 Air Force ROTC units receive the special rate of commutation funding. These five schools provide distinctive cadet uniforms to their corp of cadets. The remaining 121 units purchase Service uniforms from the military.

As an alternative to the current management of commutation funds, we believe that DoD would realize a cost avoidance by converting to a standard flat-rate system based on the cost of Service issue-in-kind uniforms, specifying the type of uniform items that the school would be required to provide, reducing reporting requirements, and eliminating the special rate of commutation. This would significantly reduce management reporting and oversight requirements. We believe that DoD should provide those schools choosing to receive commutation funds with a standard flat rate based on the cost and composition of a Service uniform plus an add-on fee or percentage for any administration, maintenance, and custodial functions provided by the school. In order to ensure that cadets are properly outfitted, and to properly control DoD funds, DoD should identify the minimum types of uniform items, for example four shirts, three trousers, etc., that the school must provide to each cadet on receipt of the flat rate.

The distinctive cadet uniform items at VPI, which receives special commutation rates, cost DoD three times more per cadet than Service uniform items purchased from a Military clothing sales store. Also, items from the Military store would require less alterations, an additional savings to DoD. DoD provided $2.82 million in commutation funding for cadets at the 14 schools that received the special rate of commutation funding for the year ending June 30, 1989. We believe that DoD can save at least $1.8 million per year by converting to a standard flat-rate system that does not use any special rates. This would equate to a 5-year cost avoidance of $9.4 million based on the current standard commutation rate. The savings to both DoD and the schools in administrative oversight and reporting, which are not quantifiable, would be in addition to that amount.

Should DoD wish to continue its current management approach, the problems identified in the remainder of this report will have to be addressed in rewriting the DoD Directive and implementing Service regulations.

Charges by VPI. Our audit at VPI highlighted the need for more specific definitions in, and consistency among, DoD and Service regulations. Faced with the dilemma caused by vague and inconsistent regulations, VPI made a comparison of them. The results of that comparison were included in a draft "Report on Uniform Commutation Allowance.... Including Procedural and Policy Recommendations Relating to the Administration of these Funds," dated December 23, 1987. The report summarized each Service regulation comparing guidance by function, identifying inconsistencies among Services, and identifying areas not addressed by a particular Service. Although the VPI report drew very few conclusions regarding the Service regulations, it was evident that VPI had interpreted or selectively followed the particular Service regulation which provided the most benefit to VPI.

We believe that many of VPI's actions and the resulting charges against DoD funds were due to misinterpretations. We could not classify the charges as totally unallowable, however, because the regulations were so vague and inconsistent. The following examples demonstrate the types of problems we found and follow the same sequence of allowable expenditures addressed in DoD Directive 1215.10. These examples were developed at VPI because VPI is the only school we visited. However, a cursory review of reports submitted by other participating schools and discussions with knowledgeable Service personnel have led us to the conclusion that similar problems exist at the other schools.

Definition of Procurement of Uniform and Related Expenses. The narrative in DoD Directive 1215.10, paragraph E.3.b.(11)(a) indicates that commutation funds may be expended for procurement, receipt, storage, and issue expenses not to exceed 10 percent of the cost of standard or distinctive uniforms. As written, this directive leaves much to the interpretation of the reader. It is unclear, for example, whether DoD intends to pay for all items a school purchases or only those items that it actually issues to cadets. Furthermore, procurement is undefined, and it is not clear as to what total "costs" the 10 percent is to be applied to, and what "costs" are subject to the 10-percent limitation. The following are examples of the problems that we found at VPI.

VPI charged DoD for uniform items issued to cadets plus a markup of 35 percent through June 30, 1988. As part of "procurement costs," VPI charged DoD for any labor-related expenses needed to put purchased items into a ready-for-issue state. These labor charges included the initial fitting and marking of uniform items and any alterations made before the items were initially issued to a cadet. VPI did not identify any specific charges subject to the 10-percent limit. Beginning on July 1, 1988, VPI charged DoD for all items purchased rather than items issued.

Since DoD Directive 1215.10 did not provide any definition of the term "procurement," we could not determine whether DoD intended to pay for all uniform items purchased, regardless of the number issued, or just those actually issued. We believe that DoD intended to reimburse the institution for new uniform items issued to cadets as is implied by paragraph E.3.b. of the DoD Directive, which states "Commutation is payment made... instead of the issue of uniforms to ROTC cadets...." We do not believe that fitting and marking and preissue alterations are intended to be included in the procurement line. Also, we could not determine where to apply the 10-percent limit, because the directive was vague. Further, if fittings and markings are considered to be allowable procurement expenses, it is not clear whether they are subject to the 10-percent limit or whether they are part of the base cost used to compute the 10 percent.

The Air Force has provided some clarification regarding its application of the 10-percent limit. AFROTC Regulation 170-1 Section C, paragraphs 18.a. and e. provide that the expenditures claimed on the procurement line of the annual report be restricted to the cost expended for standard or distinctive uniform items and that costs related to receipt, storage, and issue expenses be limited to 10 percent of this line and be claimed separately on a line titled "Other." The Army and Navy regulations do not mention the 10-percent limit whereas the Air Force guidance, although quite different, is an improvement over the DoD Directive.

The DoD Directive also needs revision to prohibit schools from charging for used uniform items once the school has recovered the full cost of buying the item. VPI requires cadets to return the entire uniform when they leave the ROTC program through graduation or for other reasons. VPI then reissues certain used uniform items to incoming cadets, especially overcoats, which appear to a have a useful life of 10 years or more even though costs are recovered through rental charges in 4 years. When VPI issues a used uniform item to a cadet, DoD is again charged for the price of a new uniform item, which we consider an overcharge. We will address this specific overcharge in a separate report. The point to be made, however, is that once an institution has recovered the full price of an inventory item from DoD, any reissue should be free from any purchase charge. Further, since DoD has paid for the item, we believe that the used item should be considered DoD property. However, DoD regulations are inconsistent on the ownership of the uniform inventory.

Ownership of Inventory and Proceeds from Sale. Determining whether to use commutation funds for all uniform items procured or only those issued gives rise to the question of ownership of inventory. DoD and Navy regulations do not address ownership of inventory. VPI believes that all uniform inventory is the property of the school. This is in all probability based on Army Regulation 700-84, chapter 10-7, which states that "Uniforms

bought with commutation funds are not U.S. property." This statement is in direct conflict with Section C, paragraphs 17.a. and 19. of AFROTC Regulation 170-1, which states that if an ROTC unit closes, or changes to issue-in-kind (Service) uniforms from a uniform commutation system, new or serviceable uniforms revert back to the Air Force.

VPI also contends that proceeds from sales of new or used uniform items are the school's property. This contention agrees with chapter 10-7(2) of Army Regulation 700-84, which states "Funds derived from sales...are not Government funds." However, this statement conflicts with AFROTC Regulation 170-1, Section C paragraph 15., which states that proceeds from the sale of new and unused uniform items must be returned to the unexpended commutation funds (which are Air Force Funds). The Air Force regulations indicate that proceeds from the sale of used nonserviceable uniform items are school funds.

In summary, to determine ownership of inventory and the proceeds of sales from the inventory, the intent of allowable procurement expenses must first be determined and specified in the DoD and Service regulations. If DoD limits the allowable procurement expenses to the cost of uniform items actually issued, then logically, any unissued items are the property of the school as would be the proceeds of the sale of new or unused uniform items. Proceeds from the sale of used items would be the property of DoD. Conversely, if DoD determines that allowable procurement expenses will cover the cost of all uniform items purchased regardless of whether issued, then logically, the inventory would belong to DoD as would proceeds from the sale of new and used uniform items. Current DoD regulations on proceeds from sales are either vague or inconsistent and must be clarified. Institutions with more than one Service ROTC unit will have difficulty selecting the applicable Service regulation. It does not seem prudent for a school to select the guidance which proves most beneficial under any particular circumstance.

Marking up the Price of Uniform Items. DoD Directive 1215.10, paragraph E.3.b.(11)(a) states that "Marking-up or raising the price of that paid by an institution when items are purchased from military inventories is not authorized." The Directive does not define "mark-up" or "military inventories." Records showed that VPI routinely marked-up (increased) the price of distinctive uniform items by 35 percent because distinctive cadet uniform items were not purchases from "military inventories." School officials told us that the mark-ups represented a recovery of cost related to fitting and marking and preissue alterations; however, they could not provide any

documentation to support their theory or the rate used. Since the DoD regulations do not define the term "mark up", we are unable to determine their intent.

Generally, cost accounting mark-ups are intended to recover indirect costs rather than direct cost, which the school was recovering. Personnel at Headquarters, AFROTC stated that mark-ups on distinctive cadet uniforms were disallowed because cadet uniforms were considered Military inventories. Personnel from the other Services felt that Military inventories meant regular Service issue or issue-in-kind uniforms. It is our opinion that before DoD can disallow a mark-up on Military inventories, the terms "mark-up" and "Military inventories" must be clearly defined and consistently applied between the Services. The allowability of any type of overhead or profit charges needs to be specifically stated in the regulations.

Alteration and Maintenance Expense Limitations. DoD Directive 1215.10, paragraph E.3.b.(11)(b) allows expenditure for "Alteration and maintenance of the uniform, which is defined as laundry, dry cleaning, renovation, alterations and sizing, not to exceed $10 per uniform." Army Regulation 700-84 provides similar guidance under paragraph 10-5.c. but does not cite the $10 limitation. The Army regulation requires that all alterations and sizing be accomplished before issue or reissue of items. AFROTC Regulation 170-1 applies the $10 limitation as a one-time charge for each new cadet entering the program rather than as a charge "per uniform." This regulation further limits allowable costs to only new cadets entering the program. The Navy Instruction does not define alteration and maintenance. None of the DoD regulations defined the term "uniform." The inconsistencies among the Service regulations add to the inconsistencies within the DoD Directive. The term "per uniform" as used in DoD Directive 1215.10, paragraph E.3.b.(11)(b) is inconsistent with the examples shown in enclosures 4 and 5 to the Directive. Both enclosures apply the $10 limitation on a per-cadet-basis and further limit the $10 by showing it as a legitimate charge for only the first, second, and third year ROTC cadet.

VPI interpreted the maximum allowable alteration expense as $10 per five uniforms per year or $50. Since cadets at VPI were issued a uniform bag of 17 items, which included 5 shirts, VPI officials felt that their cadets were issued 5 uniforms. We disagreed with VPI's definition of uniform because the uniform bag contains only four pairs of pants. When we canvassed Service personnel assigned to VPI, we found that they could not agree with what constituted a uniform. As a result, we concluded that any attempt to define "uniform" would always be subject to interpretation. The application of an alteration and maintenance limit on a per-cadet-basis, as is done in the examples shown in enclosures 4 and 5 to the DoD Directive, is the solution.

VPI has a theory that certain alterations are needed prior to initial issue. Therefore, VPI reports only postissue alterations under the alteration cost element. VPI includes preissue alterations, for example fitting and marking, as a procurement expense. This procedure is in direct contradiction to the Army regulation, which specifies that preissue alterations be included as alteration expenses. We also believe that VPI had more practical reasons for the procedure it chose. If VPI had reported preissue alterations under the alteration and maintenance cost element, it would have exceeded its own liberal interpretation of the limit on this cost category by over $14,000. Continuation of the current commutation policy would require that the Directives be clarified to specify whether preissue sizing or alterations are procurement expenses or are to be included as alterations expenses.

Salaries for Custodial Services. DoD Directive 1215.10, paragraph E.3.b.(11)(c) provides for salary payments to the property custodian for custody of uniforms purchased with commutation funds. Custodial expenses are limited to 15 percent of the basic course entitlement plus 5 percent of the advanced course and field training entitlements. All Service regulations are similarly worded. Custodial expenses are not defined in any regulation. We observed that certain expenses could have been charged as either custodial or procurement expenses. The choice exists because claimable procurement expenses specifically include "receipt, storage, and issue expenses," which we believe are custodial in nature. Because a ceiling is placed on the amount chargeable to custodial services, a school could shift those charges to procurement expenses when the ceiling is reached. We believe that expenses should be chargeable to only one expense category. Further, we believe that allowing a school to choose where an expense will be recorded defeats the purpose of placing limits on particular expense categories.

Negative Unexpended Commutation Fund Balances. DoD Directive 1215.10, paragraph E.3.b.(12) states that the "Unexpended commutation of uniform funds is the balance remaining after all commitments or obligations relating to the immediate past academic year and the amount of retained uniform commutation funds have been deducted." When a school expends more than the gross entitlement received during the reporting year, the unexpended balance at the beginning of the year could be reduced to a negative balance at the end of the year. The directive does not, however, address negative balances.

We reviewed the 147 Annual Reports filed by Army and Air Force ROTC units for the year ended June 30, 1989. Our review disclosed that 14 units reported a negative unexpended fund

balance at year end with 13 of the 14 units reporting a negative beginning balance. Thus, these schools are recovering, or attempting to recover, prior year overexpenditure in a subsequent year.

It is unclear whether DoD intended to reimburse schools that spent more than their entitlements in a given year. It appears that DoD intended to reimburse schools for expenditures up to the maximum entitlement in a given year, and no more. When schools spend more than their entitlements in a given year, the unexpended balance shown on the Annual Report should be zero. We doubt that DoD intended to allow for recovery of any given year's "excess costs" or negative balance, in subsequent years. Instead, we believe that any excess costs are costs for maintaining an ROTC unit at a school. Placing a maximum entitlement on the program forces the schools to properly manage DoD commutation funds. Conversely, providing for reimbursement in subsequent years provides no incentive to properly manage DoD funds and essentially permits the schools to operate as if they had a cost reimbursement-type contract. DoD directive 1215.10 did not adequately address the allowability of negative unexpended fund balances at year end and the recoupment of prior year charges in a subsequent year.

Investment of DoD Commutation Funds. All commutation fund regulations state that the funds may only be expended to support certain activities related to the procurement of standard or distinctive uniforms. Investing DoD funds is not one of the allowable activities cited in the regulations. Army Regulation 700-84, paragraph 10-17.c., however, states that "Interest earned on commutation funds while held by the institution is considered institution funds...." This statement not only implies that investment of DoD funds is allowed, but it also allows the institution to earn profit through the use of DoD funds.

Our audit disclosed that VPI invested DoD commutation funds in a money market fund from 1979 through 1982 and credited DoD with the interest earned. However, beginning in 1983, this practice was discontinued and VPI now keeps this interest as part of the school's funds. We were informed that other schools were also earning interest on unexpended commutation funds although we do not know the amount of interest involved. We question how DoD would recover funds lost due to poor investment decisions by the school. This is only a concern if they are DoD funds until spent by the school. If they are the school's funds upon receipt, losses would be the school's problem. Investment of DoD funds by schools and the ownership of interest earned raises legal questions DoD needs to address.

Audits of Commutation Funds. DoD Directive 1215.10, paragraph E.3.b.(12)(c)2 states "All records on the receipt and expenditure of commutation funds shall be subject to periodic audit and inspection." All Service regulations contain similar language. There were no prior audits of the use of commutation

funds at any ROTC unit. We believe that had regular audits been conducted, the interpretation problems and questionable expenditures identified in this report would have been identified and addressed. We consider the lack of regular audits of the use of DoD commutation funds to be a serious internal control deficiency and each Service should schedule periodic audits. At schools that receive commutation funds from more than one Service, joint audits or establishing audit cognizance with one Service would have to be considered if the current commutation methods were continued. Also, the cost of the many audits for these relatively small fund entities would be considerable.

Signature of the Institutional Official. Paragraph E.3.b.(12)(c)1 of the DoD Directive requires that the school official who maintains records of the receipt of funds should also sign the Annual Report. The Directive does not, however, indicate the purpose of obtaining the signature. The Directive should establish a purpose for the signature required on the Annual Report or delete the requirement. If the signature is intended to indicate that the report is complete and accurate and that the signing official will be subject to fines or other penalties if false claims are made, the signature block of the Annual Report should state this.

RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Assistant Secretary of Defense (Force Management and Personnel):

1. Either institute a standard flat-rate commutation fund system based on the cost of Military issue-in-kind uniform costs, which specifies the uniform parts that the school would be required to issue to each cadet and reduce the amount of detailed cost reporting now required by DoD Directive 1215.10, or revise DoD Directive 1215.10 to:

a. Define allowable procurement expenses as either the cost of uniform items issued to cadets or the cost of all uniform items procurred.

b. Require that procurement expenses be separately identified from other related expenses on the Annual Report on uniform commutation funds.

c. Determine ownership of new and used uniform inventory held by an institution and the ownership of proceeds from the sale of new and used uniform items.

d. Define mark-up and Military inventory and specify the allowability of charges to recover overhead or earn profit by the institution using uniform commutation funds.

e. Specify whether preissue sizing and alteration will be considered as a procurement expense or an alteration expense.

f. Define the application of alteration and maintenance in a consistent manner between the narrative in the Directive and the examples given in the enclosures to the Directive.

g. Apply alteration and maintenance limits on a per cadet basis.

h. Define custodial services to include receipt, storage, and issue expenses.

i. Specify whether negative unexpended balances are allowed.

j. Provide oversight to ensure that all Service implementing regulations are revised and consistent with DoD Directive 1215.10 and with each other.

k. Require regular periodic audits on the use of commutation funds at each school receiving commutation funds.

l. Require that responsible school officials sign the annual statement certifying that it is current, complete, and accurate and state that the signing official is subject to fines or other penalties if false claims are made.

2. Obtain legal opinions and modify DoD Directive 1215.10 to incorporate these legal opinions on whether schools:

a. Own distinctive cadet uniforms purchased with DoD commutation funds.

b. Own any proceeds from the sale of uniform items.

c. Are allowed to invest DoD commutation funds.

d. Own the interest income resulting from investment of DoD commutation funds.

MANAGEMENT COMMENTS

The Director, Education and Officer Procurement Policies, Office of the Assistant Secretary of Defense (Force Management and Personnel) concurred with both recommendations and stated that he would establish a flat-rate subsidy for uniform costs which would be based on the cost of regular issue military uniforms. We were verbally informed by the Director's staff that the establishment of a flat-rate system would be subject to legal review.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The management comments and planned actions for Recommendation 1. are responsive to the report. Based on our reevaluation of the finding, we expanded Recommendation 2. to include the issue of inventory ownership. Since the Assistant Secretary did not indicate planned corrective action for Recommendation 2, we ask that he comment on the revised recommendation in response to the final report. The Assistant Secretary did not provide estimated completion dates for the planned actions; therefore, we request that the Assistant Secretary do so in response to the final report.

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.	Cost avoidance. Internal Control.	$9.4 million in cost avoidance over a 5-year period in Reserve Personnel Appropriations
1.a. to 1.l	Compliance with regulation. Internal Control.	Monetary benefits are non-quantifiable. Benefits could not be projected because they would be based upon terminology clarification and consistency in the application of the DoD Directive and Service regulations.
2.	Cost avoidance. Potential income to DoD.	Monetary benefits are non-quantifiable. We could not determine how much DoD money was invested by VPI, for what period of time it was invested, and at what interest rate.

THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301-4000

FORCE MANAGEMENT
AND PERSONNEL

06 JUL 1990

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on the Audit of the Use of Commutation Funds at Virginia Polytechnic Institute and State University (Project No. OCD-5002)

We have reviewed the subject draft audit report and concur in the recommendations it contains. Specifically, we concur with recommendation 1, concerning establishment of a flat-rate subsidy for uniform costs based on regular issue military uniforms. We also concur with the estimate of potential monetary savings resulting from the audit as specified on page 27 of appendix A of the draft report.

This office will work with the Office of the Inspector General, the General Counsel, and the Services to ensure corrective actions are taken to remedy the deficiencies identified in the course of the audit.

for Frederick S. Berry
Colonel, USA
Director, Education & Officer
Procurement Policy

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Assistant Secretary of Defense (Force Management and Personnel), Washington. DC
Comptroller of the Department of Defense, Washington, DC

Department of the Army

Deputy Chief of Staff for Personnel, Washington, DC
Headquarters, U.S. Army ROTC Cadet Command, Fort Monroe, VA
U.S. Army ROTC Unit, VPI, Blacksburg, VA

Department of the Navy

Chief of Naval Education and Training, Pensacola, FL.
Naval Reserve Officers Training Corps Unit, VPI, Blacksburg, VA.

Department of the Air Force

Deputy Chief of Staff, Personnel, Washington, DC
Headquarters, Air Force ROTC, Maxwell AFB, Al.
Detachment 875, Air Force ROTC, VPI, Blacksburg, VA

Other

Virginia Polytechnic Institute and State University, Blacksburg, VA

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Headquarters, U.S. Army ROTC Command

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House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security
Committee on Government Operations

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