

# Inspector General

United States  
Department of Defense



Improvements Needed With Identifying  
Operating Costs Assessed to the  
Fleet Readiness Center Southwest

## Report Documentation Page

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## Acronyms and Abbreviations

BRAC	Base Realignment and Closure
CONOPS	Concept of Operations
DLA	Defense Logistics Agency
FISC	Fleet Industrial Supply Center
FRCSW	Fleet Readiness Center Southwest
MOA	Memorandum of Agreement
SS&D	Supply, Storage, and Distribution



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
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February 2, 2012

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY  
NAVAL INSPECTOR GENERAL

SUBJECT: Improvements Needed With Identifying Operating Costs Assessed to the Fleet  
Readiness Center Southwest (Report No. DODIG-2012-049)

We are providing this report for review and comment. We conducted this audit in response to an allegation made to the Defense Hotline. The Defense Hotline allegation was not substantiated. The surcharge discussed in the allegation was not charged or assessed by the Defense Logistics Agency to recapture their operating cost. The surcharge referred to in the allegation was an internal Fleet Readiness Center Southwest surcharge. Although the allegation was not substantiated, Defense Logistics Agency Aviation San Diego officials did not correctly assess their operating costs for providing supply, storage, and distribution support to the Fleet Readiness Center Southwest. As a result, Defense Logistics Agency Aviation San Diego could reduce its operating costs by approximately \$5.8 million per fiscal year. We considered management comments on a draft of this report when preparing the final report.

DoD Directive 7650.3 requires that recommendations be resolved promptly. The Deputy Director, Defense Logistics Agency Logistics Operations, responded for the Commander, Defense Logistics Agency Aviation San Diego and the Director, Defense Logistics Agency Finance Aviation. The Deputy Director, Defense Logistics Agency Logistics Operations comments to Recommendation 1 were partially responsive and Recommendations 2, 3, and 4 were not responsive. Therefore, we request that the Commander, Defense Logistics Agency Aviation San Diego and the Director, Defense Logistics Agency Finance Aviation, provide additional comments by March 5, 2012 on Recommendations 1, 2, 3, and 4 that includes a time frame for completing corrective actions.

If possible, send a .pdf file containing your comments to [audros@dodig.mil](mailto:audros@dodig.mil). Copies of the management comments must contain the actual signature of the authorizing official for your organization. We are unable to accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8876 (DSN 664-8876).

A handwritten signature in blue ink, reading "Alice F. Carey".

Alice F. Carey  
Assistant Inspector General  
Readiness, Operations, and Support





# Results in Brief: Improvements Needed With Identifying Operating Costs Assessed to the Fleet Readiness Center Southwest

## What We Did

We initiated this audit in response to an allegation to the Defense Hotline. Initially, our objective was to determine whether the Defense Logistics Agency (DLA) correctly assessed surcharges for material shipments to the Fleet Readiness Center Southwest (FRCSW). Specifically, we determined whether DLA appropriately assessed surcharges for standard orders and hazardous materials that relate to the agency's operating costs. However, DLA Aviation San Diego, California, officials did not use a surcharge to assess their operating costs. Therefore, we revised our objective to determine whether DLA Aviation San Diego correctly assessed its operating costs to FRCSW for providing supply, storage, and distribution (SS&D). DLA Aviation San Diego assessed their total estimated operating costs to FRCSW through an annual fixed-price agreement. Of the \$70.1 million in estimated operating costs from FY 2009 through FY 2011, we reviewed \$59.3 million of the estimated operating costs to determine whether the cost were allowable and supportable.

## What We Found

DLA Aviation San Diego officials did not correctly assess their operating costs for providing SS&D support to FRCSW. Specifically, DLA Aviation San Diego officials assessed \$17.6 million in operating costs for services that were outside the scope of their SS&D responsibilities and \$5.1 million in operating costs for services that were potentially not SS&D. This occurred because the Commander, DLA Aviation San Diego, the Director, DLA Finance Aviation, and Comptroller, FRCSW did not develop a local

support agreement that clearly identified services performed and costs associated with those services. In addition, neither DLA Finance Aviation Office nor DLA Aviation San Diego Material Management Division personnel developed or implemented policies and procedures that identified, estimated, and documented DLA Aviation San Diego's operating costs. As a result, DLA Aviation San Diego could reduce its operating costs for providing SS&D to FRCSW by approximately \$5.8 million per fiscal year. Furthermore, DLA Aviation San Diego could not provide sufficient documentation for \$13.9 million in estimated SS&D support costs.

## What We Recommend

We recommended that the Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation:

- coordinate with the Comptroller, FRCSW to develop and implement a local support agreement;
- establish a quality control process to review the operating costs assessed to the FRCSW; and
- reduce operating costs in future years by not performing services outside the scope of SS&D support or that are not the responsibility of DLA Aviation San Diego.

## Management Comments and Our Response

The Deputy Director, DLA Logistics Operations, provided comments on the draft report. However, management comments were either partially responsive or not responsive. We request DLA provide comments by March 5, 2012.

## Recommendations Table

<b>Management</b>	<b>Recommendations Requiring Comment</b>	<b>No Additional Comments Required</b>
Director, Defense Logistics Agency Finance Aviation	1, 2, 3, 4	
Commander, Defense Logistics Agency Aviation San Diego	1, 2, 3, 4	

**Please provide comments by March 5, 2012.**

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# Introduction

## Objective

We initiated this audit in response to a Defense Hotline allegation. Initially, our objective was to determine whether Defense Logistics Agency (DLA) correctly assessed surcharges for material shipments to Fleet Readiness Center Southwest (FRCSW); specifically, whether DLA appropriately assessed surcharges for standard orders and hazardous materials that relate to the agency's operating costs. However, DLA Aviation San Diego, California, officials did not use a surcharge to assess their operating costs for providing supply, storage, and distribution (SS&D) support to FRCSW. DLA Aviation San Diego officials assessed their total estimated operating costs to FRCSW through an annual fixed-price agreement. Therefore, we revised our objective to determine whether DLA Aviation San Diego officials correctly assessed their operating costs to FRCSW for providing SS&D support. See Appendix A for a discussion our scope and methodology.

The complainant alleged that DLA Aviation San Diego officials incorrectly assessed a surcharge to FRCSW to recapture their operating expenses on standard and hazardous material orders. As a result, FRCSW cost centers overcharged customers on every material order.

The Defense Hotline allegation was not substantiated. The surcharge discussed in the allegation was not charged or assessed by DLA to recapture their operating cost. The surcharge referred to in the Defense Hotline allegation was an internal FRCSW surcharge. The Comptroller, FRCSW implemented the surcharge to allocate and collect the costs for material management support from the individual cost centers. Although the Defense Hotline was not substantiated, the allegation directly resulted in identifying internal control weaknesses in DLA Aviation San Diego's process for estimating operating cost.

## Background

### ***Material Management Support Partnership Established***

On June 30, 2003, the Naval Air Systems Command and Naval Supply Systems Command entered into a memorandum of agreement (MOA) to define the overarching strategy of the FRCSW and Fleet and Industrial Supply Center (FISC)<sup>1</sup> partnership. The MOA provided a framework for both FRCSW and FISC to transfer the material and material management functions from FRCSW to FISC San Diego. In addition, the MOA stated that FISC San Diego was responsible for managing material support requirements to meet the defined performance standards of FRCSW. The goal of the MOA was to

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<sup>1</sup>During FY 2009, FISC became DLA Aviation. Also, the Naval Air Systems Command Depot North Island, Naval Base Coronado, became FRCSW.

improve FRCSW material availability in support of aviation depot maintenance, depot production efficiency, and weapons system availability to the warfighter.

### ***Base Realignment and Closure Recommendation Realigned SS&D Functions***

On September 8, 2005, the Base Realignment and Closure (BRAC) Commission Report Recommendation #177 (BRAC Recommendation #177) realigned SS&D functions at industrial depot and shipyard locations throughout the United States from Military Services to DLA. In February 2009, with the implementation of BRAC Recommendation #177, DoD realigned and assigned FISC San Diego personnel who performed SS&D functions to DLA Aviation San Diego.

To implement the BRAC Commission recommendation, DLA issued the “Navy – DLA BRAC Supply, Storage, and Distribution Concept of Operations (BRAC CONOPS),” April 17, 2009. The BRAC CONOPS provides the DLA approach to achieve both the initial state (Day 1) and the ultimate end state implementation of BRAC Recommendation #177. In the initial state, DLA used existing Navy information technology systems, processes, procedures, and funding to provide SS&D support to industrial depots. According to the BRAC CONOPS, to achieve the end state,

- DLA will capitalize all mutually agreed upon inventories from BRAC designated Navy Industrial Activities;
- DLA and Navy information technology systems, processes, procedures, and funding will be integrated based upon mutually agreed upon functional requirements;
- DLA will acquire all consumables, DLA managed and non-DLA managed, with Defense Working Capital Fund obligation authority; and
- BRAC designated Navy Industrial Activities will transfer all mutually agreed upon facilities (currently maintained by Operations and Maintenance, Navy funds) to DLA.

According to DLA Aviation personnel, part of the end state includes DLA Aviation developing a standard and consistent overhead rate to assess the DLA Aviation San Diego operating cost to FRCSW. Headquarters, DLA Aviation will use historical operating cost data from DLA Aviation San Diego, starting with FY 2009, as the basis for the overhead rate. Therefore, an accurate depiction of the DLA Aviation San Diego operating cost is needed to ensure that only SS&D services are represented.

### ***DLA Aviation Managed SS&D Operations***

DLA Aviation was the supply chain owner for air aviation and space support within DoD and managed SS&D operations. DLA Aviation San Diego served as the single point of contact responsible for the daily operations of all retail-level SS&D support for FRCSW. DLA Aviation San Diego worked with FRCSW to provide critical aviation supply chain parts and helped FRCSW sustain scheduled and unscheduled depot-level maintenance,

repair, and manufacturing processes. DLA Aviation San Diego provided SS&D support for specific aircrafts, engines, manufacturing, and major hydraulics and avionics components repair programs.

***DLA Operating Costs Assessed to FRCSW***

DoD Regulation 7000.14-R, “Financial Management Regulation,” volume 11B, chapter 1, “Defense Working Capital Funds General Policies and Procedures,” April 2010, states that Government entities that are a part of the DoD Working Capital Fund provide goods and services on a reimbursable basis to other Activities within DoD and to non-DoD Activities when authorized.

Additionally, the DoD Regulation 7000.14-R, “Financial Management Regulation,” volume 11A, chapter 1 “General Reimbursement Procedures and Supporting Documentation,” April 2008, further defines the expense categories reimbursable to a DoD Working Capital Fund activity. Reimbursable expense categories include expenses (such as direct labor, overhead rates, transportation, contract costs, and contract administrative costs).

As a Defense Working Capital Funds activity, DLA Aviation San Diego may request reimbursement for those expenses related directly or indirectly to providing SS&D support to FRCSW. DLA Aviation San Diego officials requested reimbursement from FRCSW based on the annual estimated operating costs. DLA Aviation San Diego officials billed FRCSW for SS&D support quarterly and FRCSW made payment to DLA Aviation quarterly with a military interdepartmental purchase request. From FY 2009 through FY 2011, DLA Aviation San Diego officials assessed approximately \$70.1 million to FRCSW for providing SS&D support. Table 1 identifies DLA Aviation San Diego costs assessed to FRCSW from FY 2009 through FY 2011.

**Table 1. DLA Aviation San Diego’s Operating Costs**

<b>Fiscal Year</b>	<b>Total Operating Costs (millions)</b>
2009	\$24.1
2010	\$22.5
2011	\$23.5
<b>Total</b>	<b>\$70.1</b>

After FRCSW officials paid DLA Aviation San Diego, the Comptroller, FRCSW allocated the DLA Aviation San Diego estimated operating costs to its cost centers

through a material recovery rate.<sup>2</sup> The Comptroller, FRCSW created the material recovery rate as an internal method for assessing and collecting the costs for material management support to the individual cost center. In FY 2009 and FY 2010, FRCSW allocated the material recovery rate to 21 cost centers; in FY 2011, FRCSW officials allocated the material recovery rate to 25 cost centers.

## **Internal Controls Over Identifying and Estimating Operating Costs Were Ineffective**

DoD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures,” July 29, 2010, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses for the Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation. The Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation did not have a local support agreement that clearly outlined the details of their partnership with the FRCSW or written policies and standard operating procedures for developing or documenting estimated operating costs for FRCSW. We will provide a copy of the report to the senior officials responsible for internal controls in DLA and the Department of the Navy.

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<sup>2</sup> The material recovery rate is a surcharge added when material ordered is received, which can adjust to recover DLA costs associated with material management support.

## **Finding. Processes for Identifying and Estimating Operating Costs Need Improvement**

DLA Aviation San Diego officials did not correctly assess their operating costs for providing SS&D support to FRCSW. Specifically, DLA Aviation San Diego officials assessed \$17.6 million in operating costs for services that were outside the scope of their SS&D responsibilities and \$5.1 million in operating costs for services that were potentially not SS&D. In addition, DLA Aviation San Diego officials did not always support estimated operating costs with sound estimation and documentation practices.

This occurred because the Commander, DLA Aviation San Diego; the Director, DLA Finance Aviation; and the Comptroller, FRCSW did not develop a local support agreement that clearly identified services performed and costs associated with those services. In addition, neither DLA Finance Aviation Office nor DLA Aviation San Diego Material Management Division personnel developed or implemented written policies or standard operating procedures that identified, estimated, and documented DLA Aviation San Diego's operating costs.

As a result, DLA Aviation San Diego officials could reduce their operating costs for providing SS&D support to FRCSW by approximately \$5.8 million per fiscal year (average from FY 2009 through FY 2011). Furthermore, DLA Aviation San Diego could not provide sufficient documentation for \$13.9 million in estimated SS&D support cost.

## **DoD and DLA Guidance Requires Agreements and Defines SS&D**

### ***Support Agreement Criteria for Reimbursable Costs***

DoD Instruction 4000.19, "Interservice and Intragovernmental Support," August 9, 1995, provides policy and procedures for interservice support. According to DoD Instruction 4000.19, "recurring interservice support that requires reimbursement must be documented by a signed support agreement." A support agreement between two organizations should outline the time period in which the service will be provided, the type and category of service that will be provided, the estimated annual amount needed to fund the agreement, and the general provisions and details on the services being provided. DoD Regulation 7000.14-R, "Financial Management Regulation," volume 11A, chapter 1, April 2008, states that without an agreement, there is no assurance that there was an agreement between parties on the services to be provided or that payment is required.

## ***DLA Business Plan Defined SS&D Functions***

The “DLA Business Plan Supply, Storage, and Distribution Management Reconfiguration #177,” August 2, 2009, and February 1, 2010, (DLA Business Plan) provides specific directions on the SS&D functions transferred and which Components within DLA will maintain certain functions. The DLA Business Plan defines SS&D as material support provided to Industrial Depots for scheduled repair and overhaul of aircraft, engines, components, and other maintenance and production workloads. The SS&D functions solely relate to ordering, storing, and issuing material to ensure industrial depots can perform maintenance, repair, and overhaul functions. Functions included under SS&D consist of the following:

- stock control and shelf-life management,
- physical inventory management and warehousing,
- storage material handling and material issuing,
- packaging and preserving,
- storage and distribution quality assurance, and
- shipping and material handling and traffic management.

In accordance with the DLA Business Plan, DLA Aviation San Diego officials should only perform services that directly or indirectly relate to SS&D for FRCSW.

## **Operating Costs Assessed, but Included Costs Outside of Scope and Unsupported Estimates**

DLA Aviation San Diego officials did not correctly assess their operating costs for providing SS&D support to the FRCSW. Specifically, DLA Aviation San Diego personnel included costs for services that were outside the scope of their SS&D responsibilities. In addition, DLA Aviation San Diego personnel included operating costs that were not supported by sound estimation or documentation practices.

DLA Aviation San Diego personnel identified their operating costs annually for providing SS&D support to FRCSW and estimated their operating costs based on costs associated with labor and with contractor services. From FY 2009 through FY 2011,

DLA Aviation San Diego personnel identified operating costs, valued at approximately \$70.1 million. Table 2 shows the breakdown of DLA Aviation San Diego total estimated and reviewed operating costs from FY 2009 through FY 2011.

**Table 2. DLA Aviation San Diego’s Operating Costs**

Fiscal Year	Labor (millions)		Contractor Services (millions)		Total Operating Costs (millions)	
	Estimated	Reviewed	Estimated	Reviewed	Estimated	Reviewed
2009	\$12.3	\$10.0	\$11.8	\$10.5	\$24.1	\$20.5
2010	11.8	9.8	10.7	9.2	22.5	19.0
2011	12.6	10.4	10.9	9.4	23.5	19.8
<b>Total</b>	<b>\$36.7</b>	<b>\$30.2</b>	<b>\$33.4</b>	<b>\$29.1</b>	<b>\$70.1</b>	<b>\$59.3</b>

Of the \$70.1 million in operating costs from FY 2009 through FY 2011, we reviewed \$59.3 million (85 percent) to determine whether the \$59.3 million in DLA Aviation San Diego operating costs were directly or indirectly related to providing SS&D support to FRCSW. In addition, we reviewed the \$59.3 million to determine whether the services being provided were the responsibility of DLA Aviation San Diego or other Activities. Finally, we evaluated whether the estimated operating costs were supported with sufficient documentation and sound estimating methodology.

***Expenses Not Related to SS&D Support***

From FY 2009 through FY 2011, DLA Aviation San Diego officials assessed approximately \$17.6 million in operating costs to FRCSW that were for services outside the scope of SS&D

*From FY 2009 through FY 2011, DLA Aviation San Diego officials assessed approximately \$17.6 million. . . outside the scope of SS&D support.*

support. Those services did not directly or indirectly relate to providing SS&D support or they were the responsibility of another activity.

See Table 3 for the cost categories included in DLA Aviation San Diego’s operating costs that were for services outside the scope of SS&D support or were not the responsibility of DLA Aviation San Diego from FY 2009 through FY 2011.

**Table 3. DLA Aviation San Diego Costs Not Related to SS&D Support (millions)**

<b>Cost Category</b>	<b>FY 2009</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>Total Costs Not Supported</b>
Scheduling Repairs and Overhauls	\$1.5	\$1.2	\$1.3	<b>\$ 4.0</b>
Bill of Material	2.8	2.0	2.2	<b>7.0</b>
Information Systems Support	2.4	2.1	2.1	<b>6.6</b>
<b>Total</b>	<b>\$6.7</b>	<b>\$5.3</b>	<b>\$5.6</b>	<b>\$17.6</b>

### **Costs Incurred to Provide Scheduled Repairs and Overhauls**

DLA Aviation San Diego officials included approximately \$4 million in contractor support (related to assisting with scheduling repairs and overhauls for aircraft coming to the FRCSW) in their operating costs from FY 2009 through FY 2011. The support provided under contract N68936-05-D-0013<sup>3</sup> did not relate to SS&D services because it did not involve ordering, storing, or issuing material for actual repairs or overhauls. The Commander, DLA Aviation San Diego and the Director, DLA Aviation San Diego, Material Management Division agreed that these services were outside of the scope of SS&D. According to the Director, DLA Aviation San Diego, Material Management Division, DLA Aviation San Diego officials included the \$4 million in contractor support in its operating costs at the request of the Comptroller, FRCSW. The Director further explained that the Comptroller, FRCSW requested DLA Aviation San Diego to include the contract costs for scheduling repairs and overhauls in its operating costs to ensure all costs related to material management were fully captured in DLA Aviation San Diego operating costs.

FRCSW officials should have either performed these services or accounted for the contractor cost themselves, but, instead, they asked DLA Aviation San Diego to include the contract cost for scheduling repairs and overhauls in their operating costs. Although the Comptroller, FRCSW made this request, DLA Aviation San Diego officials should not have included these costs because the services provided did not directly or indirectly relate to SS&D support. DLA could reduce its operating costs for providing SS&D support to FRCSW, if it excludes expenses for scheduling repairs and overhauls. Based

<sup>3</sup> We did not evaluate the entire period of the contract’s performance. We evaluated the contract from FY 2009 through FY 2011, which was valued at approximately \$3.5 million.

on the 3-year average from FY 2009 through FY 2011, DLA Aviation San Diego could reduce its operating costs by approximately \$1.3 million per fiscal year.

### **Contract Costs Incurred for Bill of Material Services**

From FY 2009 through FY 2011, DLA Aviation San Diego officials included in their operating costs approximately \$7 million in contract support related to developing and maintaining the material requirements for the repair or overhaul of aircraft. Specifically, DLA Aviation San Diego used the bill of material<sup>4</sup> application to build, structure, modify, and review material needed to conduct repairs and overhauls. DLA Aviation San Diego personnel performed the bill of material services at the request of the FRCSW Comptroller Office; however, DLA Aviation San Diego should not have performed these services. According to the Comptroller, FRCSW, DLA Aviation San Diego performed the bill of material service because FRCSW considered it a part of material management. Although the bill of material service indirectly supported SS&D by defining the material that needed to be ordered, FRCSW, as the owner of the production line, should identify material requirements needed for repairs and overhauls. In addition, the MOA stated that FRCSW was responsible for performing the bill of material service. The Director, Material Management Division, confirmed that FRCSW should perform the bill of material service because it involved determining the requirements for ordering material. Therefore, DLA Aviation San Diego should not perform the bill of material service for FRCSW, which would reduce their operating cost for providing SS&D support to FRCSW. Based on the 3-year average from FY 2009 through FY 2011, DLA Aviation San Diego could reduce its operating costs by approximately \$2.3 million per fiscal year.

### **Information Systems Support Costs Incurred by DLA**

From FY 2009 through FY 2011, DLA Aviation San Diego officials included approximately \$6.6 million as operating costs associated with obtaining information technology equipment and system support from FRCSW. According to the DLA Aviation San Diego personnel, FRCSW charged it for information technology equipment and system support used to capture all its cost associated with material management. However, the BRAC CONOPS states that FRCSW (as a Navy Activity) will provide or pay for information technology equipment and system support for DLA to accomplish its SS&D support. Therefore, FRCSW, not DLA Aviation San Diego, should be responsible for the \$6.6 million associated with information technology equipment and system support. When DLA Aviation San Diego officials no longer pay FRCSW for information technology equipment and system support, their operating costs will be reduced. Based on the 3-year average from FY 2009 through FY 2011, DLA Aviation San Diego could reduce its operating costs by approximately \$2.2 million per fiscal year.

The Director, DLA Finance Aviation and Commander, DLA Aviation San Diego should reduce its operating costs in future years by not performing services that are outside the scope of SS&D support or are not the responsibility of DLA Aviation San Diego. Such

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<sup>4</sup> A bill of material generates new material requirements lists from existing material lists and verifies the lists before committing them to a database.

services include scheduling repairs and overhauls, bill of materials, and information systems support.

**Expenses Potentially Not Related to SS&D Support**

From FY 2009 through FY 2011, DLA Aviation San Diego officials included in their operating costs approximately \$5.1 million in potential unallowable costs associated with managing hazardous material that potentially was not the responsibility of DLA Aviation San Diego. The MOA and DLA Business Plan assigned conflicting duties for providing the hazardous material management. Specifically, the MOA states that FRCSW should provide a portion of hazardous material management; while, the DLA Business Plan states that the hazardous material management will become the responsibility of DLA. The Commander, DLA Aviation San Diego stated that at least a portion of the cost associated with hazardous material management should be removed from their operating costs. Because the MOA and the DLA Business Plan assigned conflicting duties, we could not determine which organization (FRCSW or DLA) should cover the costs associated with managing hazardous material support. DLA Aviation San Diego could not provide a definitive determination on its responsibility for hazardous material management. In September 2011, as outlined in the DLA Business Plan, DLA Aviation San Diego assumed responsibility for providing hazardous material management to FRCSW; therefore, DLA Aviation San Diego did not reduce their overall operating costs.

**Operating Cost Estimates Not Supported**

For FY 2009 and FY 2010, DLA Aviation San Diego officials did not provide sufficient documentation or sound estimates to support \$13.9 million in estimated costs for FRCSW. Table 4 provides the cost categories and estimates that DLA Aviation San Diego did not support from FY 2009 through FY 2010.

**Table 4. DLA Aviation San Diego Operating Costs Not Supported (millions)**

<b>Cost Category</b>	<b>FY 2009</b>	<b>FY 2010</b>	<b>Total Cost Not Supported</b>
Indirect Labor 1	\$4.1	\$0.0	<b>\$4.1</b>
Indirect Labor 2	2.1	0.0	<b>2.1</b>
F/A – 18 North Island	0.7	0.0	<b>0.7</b>
Manufacturing	0.6	0.6	<b>1.2</b>
Component – Landing	0.5	0.5	<b>1.0</b>
Multi-Line	0.7	0.0	<b>0.7</b>
Component – Aviation	0.7	0.6	<b>1.3</b>
Components – Instrument	0.5	0.0	<b>0.5</b>
Enterprise Team	1.7	0.0	<b>1.7</b>
Overtime for Contractor Services	0.6	0.0	<b>0.6</b>
<b>Total</b>	<b>\$12.2</b>	<b>\$1.7</b>	<b>\$13.9</b>

## **DLA FY 2009 Estimated Operating Costs for Providing SS&D Not Supported**

For FY 2009, DLA Aviation San Diego personnel were unable to provide sufficient documentation to support the assumptions and underlying basis for \$12.2 million in estimated labor and contract services costs. According to various DLA Aviation San Diego officials, in February 2009, when they transitioned to FISC, San Diego officials did not provide documentation to support the estimated operating costs for providing SS&D support to FRCSW. DLA Aviation San Diego personnel did not retain supporting documentation from FISC San Diego because the Director, Material Management Division did not believe it was necessary to retain supporting documentation. As a result, DLA Aviation San Diego personnel could not support \$12.2 million in operating costs for FY 2009.

## **DLA FY 2010 Estimated Operating Costs for Providing SS&D Not Supported**

DLA Aviation San Diego officials were unable to provide sound estimating and documenting practices for approximately \$1.7 million in estimated labor costs for portions of FY 2010. We could not validate<sup>5</sup> portions of the FY 2010 DLA Aviation San Diego cost estimates using the DLA Aviation San Diego methodologies, assumptions, and other factors. For example, DLA Aviation San Diego's cost estimate for manufacturing components was \$546,488. However, using the methodology explained by DLA Aviation San Diego personnel, we determined that DLA Aviation San Diego underestimated its manufacturing cost by \$180,747 (33 percent variance). In addition, we could not validate the cost estimate for two other DLA Aviation San Diego labor cost categories, valued at \$1,124,490. The variances for these two cost categories were at least 16 percent from the DLA Aviation San Diego estimated amount. DLA Aviation San Diego personnel were unable to explain why there was a significant variance. As a result, DLA Aviation San Diego officials could not support approximately \$1.7 million in operating costs with sound estimating and documenting practices for portions of FY 2010.

## **Operating Costs Assessed Were Allowable and Supportable**

Although DLA Aviation San Diego were unable to provide sufficient documentation or sound estimating to support \$13.9 million in estimated operating costs for FY 2009 and portions of FY 2010, DLA Aviation San Diego personnel did provide sound estimating and sufficient documentation for approximately \$22.6 million in estimated operating costs for portions from FY 2010 through FY 2011. For the \$22.6 million, we were able to validate DLA Aviation San Diego's cost estimates using its methodology,

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<sup>5</sup> When validating the DLA Aviation San Diego estimated costs, we determined that if the difference between our recalculation of the estimate did not exceed 15 percent, then the DLA Aviation San Diego estimated amount was considered reasonable.

assumptions, documentation, and other factors. Table 5 provides the cost categories and estimates that were allowable and supportable from FY 2010 through FY 2011.

**Table 5. Operating Costs That Were Allowable and Supportable  
(millions)**

<b>Cost Category</b>	<b>FY 2010</b>	<b>FY 2011</b>	<b>Total Allowed and Supportable Costs</b>
Indirect 1	\$ 4.2	\$ 4.2	<b>\$ 8.4</b>
Indirect 2	2.2	2.4	<b>4.6</b>
F/A – 18 North Island	0.7	0.7	<b>1.4</b>
Manufacturing	0.0	0.7	<b>0.7</b>
Hydraulics/ Comp Landing	0.0	0.7	<b>0.7</b>
Multi - Line	0.6	0.0	<b>0.6</b>
H-6/ H-53 North Island	0.0	0.7	<b>0.7</b>
Comp Aviation	0.0	0.5	<b>0.5</b>
Comp Instrument	0.4	0.5	<b>0.9</b>
E – Team	2.2	1.9	<b>4.1</b>
<b>Total</b>	<b>\$10.3</b>	<b>\$12.3</b>	<b>\$22.6</b>

DLA Aviation San Diego’s operating costs were relatively consistent from FY 2009 through FY 2011. Over this 3-year period, DLA Aviation San Diego made improvements in supporting and documenting the methodologies, assumption, and other factors used to estimate its operating costs. Although DLA Aviation made improvements over the years, we could not determine if a rate adjustment was required, without supporting documentation for the \$13.9 million in operating costs.

### **Inadequate Processes for Identifying and Estimating Operating Costs**

The Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation did not have adequate processes for identifying and estimating their operating costs. Specifically, the Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation did not coordinate the development of a local support agreement with the Comptroller, FRCSW. Furthermore, the Commander and the Director did not develop and implement written policies and procedures governing the process for identifying and estimating their operating costs.

## ***Lack of Support Agreement to Define Business Relationship***

The Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation did not develop a local support agreement with the Comptroller, FRCSW that clearly identified services performed and the cost associated with those services.

*The Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation did not develop a local support agreement with the Comptroller, FRCSW. . . .*

DoD Instruction 4000.19 states that Activities entering into recurring interservice support that require reimbursement must document the partnership by a signed support agreement. Before the February 2009 implementation of the BRAC recommendation, the partnership between FRCSW and DLA Aviation San Diego, then FISC, operated under the MOA as overarching guidance. However, since the realignment of FISC to DLA, DLA Aviation San Diego and FRCSW did not establish a local support agreement.

According to DLA Aviation San Diego and FRCSW officials, they still operated their partnership as established under the MOA. However, the MOA was not a sufficient support agreement because it does not include key elements outlined in DoD Instruction 4000.19. For example, the MOA does not include the following:

- cost per unit,
- total annual reimbursement cost,
- agreement on billing and payment, or
- time frame for services to be rendered.

For this reason, DoD Instruction 4000.19 requires a support agreement if a MOA is used. As a result of the Commander, DLA Aviation San Diego; the Director, DLA Finance

*The Commander stated that he allowed DLA Aviation San Diego to include these costs and perform these services because he “did not have a mechanism in place to say no to the Comptroller, FRCSW.”*

Aviation; and the Comptroller, FRCSW not developing a local support agreement, decisions that affected DLA Aviation San Diego’s operating costs for SS&D were not formally documented and contributed to DLA Aviation San Diego performing services that were outside the

scope of SS&D support. Specifically, DLA Aviation San Diego included costs for contractor support for scheduling repairs and overhauls and performed bill of material services, when the services were either not related to providing SS&D or were not the responsibility of DLA Aviation San Diego. The Commander stated that he allowed DLA Aviation San Diego to include these costs and perform these services because he “did not have a mechanism in place to say no to the Comptroller, FRCSW.” According to the Commander, he accommodated his customer to provide sufficient customer service.

The Commander, DLA Aviation San Diego and the Director, DLA Finance Aviation should coordinate with the Comptroller, FRCSW to develop and implement a local

support agreement that, at a minimum, clearly defines DLA Aviation San Diego's roles and responsibilities, SS&D services, and costs associated with the agreed upon services. A formal local support agreement will provide SS&D guidance to DLA Aviation San Diego and prevent the agency from performing SS&D services outside of its responsibility.

### ***Lack of Written Policies and Standard Operating Procedures***

The Director, Material Management Division, DLA Aviation San Diego and the Director, DLA Finance Aviation did not develop or implement procedures that defined the process for identifying, estimating, and documenting DLA Aviation San Diego's operating costs for SS&D support to FRCSW.

*The Director, Material Management Division, DLA Aviation San Diego and the Director, DLA Finance Aviation, did not develop or implement procedures that defined the process for identifying, estimating, and documenting DLA Aviation San Diego's operating costs for SS&D support to FRCSW.*

Neither DLA Aviation Finance Office nor DLA

Aviation San Diego Material Management Division officials implemented an independent quality control process to ensure all costs assessed annually to FRCSW were appropriate. This occurred because the Director did not believe it was necessary to develop and implement guidance because DLA Aviation San Diego personnel performed these estimating functions for more than 3 years.

The Director, Material Management Division, did not document methodologies or processes used and assumptions made to identify and estimate their operating costs. In addition, DLA Aviation San Diego personnel did not maintain documentation to support the development of FY 2009 estimated operating cost.

After the implementation of BRAC Recommendation #177, the Director, DLA Finance Aviation, did not provide sufficient guidance to DLA Aviation San Diego to ensure all operating costs assessed were within the scope of SS&D support and DLA Aviation San Diego's responsibility. Specifically, DLA Finance Aviation and DLA Aviation San Diego did not have an independent quality control review process in place to prevent costs from being included in the DLA Aviation San Diego operating budget that were not for SS&D services or fully supported. DLA Finance Aviation officials were unaware that DLA Aviation San Diego included costs outside of their responsibility, such as costs for contractor support for scheduling repairs and overhauls and performed bill of material services. According to the Director, DLA Finance Aviation, her office was unaware that DLA Aviation San Diego included costs outside of their responsibility because under the BRAC initial state, DLA Aviation Components continued to operate using the Navy's processes and procedures. The initial implementation of the BRAC recommendation permitted DLA Aviation San Diego to provide support to FRCSW, without establishing processes and procedures.

The Director, DLA Finance Aviation and the Commander, DLA Aviation San Diego should develop and implement written policies and standard operating procedures that

outline the process for identifying and estimating DLA Aviation San Diego's operating costs for providing SS&D support to FRCSW. The written policies and procedures should include an independent quality control process to review the operating costs assessed to the FRCSW to prevent the inclusion of costs for services that are not related to SS&D support.

## **Conclusion**

DLA Aviation San Diego did not correctly assess its operating cost for providing SS&D support to the FRCSW. Specifically, DLA Aviation San Diego:

- assessed \$17.6 million in operating costs for services that were outside the scope of their SS&D responsibilities, and
- assessed \$5.1 million in operating costs for services that were potentially not SS&D support.

As a result, DLA Aviation San Diego could reduce its operating costs by approximately \$5.8 million per fiscal year. Furthermore, DLA Aviation San Diego officials could not provide sufficient documentation for \$13.9 million in SS&D support costs assessed to FRCSW from FY 2009 through FY 2010.

## **Management Comments on Internal Controls and Our Response**

### ***Deputy Director, Defense Logistics Agency Logistics Operations Comments***

The Deputy Director, DLA Logistics Operations, provided comments on the internal control weaknesses identified in the report. The Deputy Director stated that the report did not reflect an internal control weakness on the part of the Director, DLA Finance Aviation. The Deputy Director indicated that DLA that Finance Aviation was not responsible for developing a support agreement because DLA Finance Aviation could not identify which services should or should not be provided. Therefore, DLA Finance Aviation would not put standard operating procedures in place for other than financial related tasks. However, the Deputy Director agreed that an agreement should be put in place to document the support being provided by FRCSW. The Deputy Director stated an inter-service support agreement was not the proper vehicle to define the SS&D services performed between DLA Aviation San Diego and FRCSW. The Deputy Director indicated the purpose of an inter-service support agreement is to detail the specific installation support that a base host will provide to its tenants. Finally, the Deputy Director indicated a MOA or a performance based agreement, negotiated by the Director, DLA Aviation Customer Operations, would be more appropriate.

### ***Our Response***

We disagree with the Deputy Director's comments. DLA Finance Aviation did not have policies and procedures to govern budgeting and reimbursable support agreements, which

represented an internal control weakness. DLA Finance Aviation serves as the principal adviser and assistant to the commander of the aviation supply chain in implementing policies and objectives relating to financial management, including resourcing of operations. One of the responsibilities of DLA Finance Aviation is administration of the interservice support programs. In addition, DLA Finance Aviation ensures execution with respect to policies relating to budgeting, standard pricing, cost analysis, work years and reimbursements. Therefore, DLA Finance Aviation should develop policies and procedures related to identifying, estimating, and documenting DLA Aviation San Diego's reimbursable operating cost.

The Deputy Director stated an MOA was more appropriate for identifying the services performed by DLA Aviation San Diego to FRCSW. However, DoD Instruction 4000.19, states that a support agreement is required if an MOA is used to document the agreement. Further, DoD Instruction 4000.19 defines a support agreement as an agreement to provide recurring support to another DoD activity, Military Service, or Field Activity; it should include the specifics of the basis for calculating reimbursement charges for each service, establish billing and reimbursement process, and specify other terms and conditions of the agreement. Therefore, a support agreement or a MOA with a support agreement is the appropriate vehicle to document the partnership between DLA Aviation San Diego and FRCSW.

## **Recommendations, Management Comments, and Our Response**

**1. We recommend the Commander, Defense Logistics Agency Aviation San Diego and the Director, Defense Logistics Agency Finance Aviation, coordinate with the Comptroller, Fleet Readiness Center Southwest to develop and implement a local support agreement to clearly define the Defense Logistics Agency Aviation San Diego roles and responsibilities, supply storage and distribution services to be performed, and cost associated with the agreed to services.**

### ***Deputy Director, Defense Logistics Agency Logistics Operations Comments***

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA Finance Aviation and the Commander, DLA Aviation San Diego, disagreed with the recommendation. As written, the Deputy Director disagreed with using an inter-service support agreement to document the partnership between DLA Aviation San Diego and FRCSW because the intent was not to define the SS&D services to be performed. According to the Deputy Director, the purpose of an inter-service support agreement is to detail the specific installation support that a base host will provide to its tenants. Instead, the Deputy Director recommended using a MOA or a performance based agreement to document the support being provided by DLA Aviation San Diego to FRCSW. The Deputy Director stated that DLA Aviation Customer Operations and DLA Aviation Finance should review operating cost estimates for reasonableness. In addition, the

Deputy Director indicated the Director, DLA Customer Operations should negotiate the agreement through DLA Aviation San Diego, its local command.

### ***Our Response***

The Deputy Director, DLA Logistics Operations comments were partially responsive. Although the Deputy Director did not agree with a support agreement, the Deputy Director did agree that an agreement should be put in place. According to DoD Instruction 4000.19, if a MOA is used to document the agreement, a support agreement is required. Since DLA Aviation San Diego is receiving reimbursement from FRCSW for its operating cost a support agreement is required. Therefore, a support agreement is the appropriate vehicle to document the partnership between DLA Aviation San Diego and FRCSW. A MOA will not replace the need for a support agreement. DoD Instruction 4000.19 states that a support agreement is an agreement to provide recurring support to another DoD activity, Military Service, or Field Activity; it should include the specifics of the basis for calculating reimbursement charges for each service, establish billing and reimbursement process, and specify other terms and conditions of the agreement.

In addition, the Deputy Director did not provide a time frame for establishing an agreement. Therefore, we request that the Deputy Director, reconsider his position on developing a support agreement between DLA Aviation San Diego and FRCSW. In addition, we request that the Deputy Director, provide a time frame for when completing corrective actions.

**2. We recommend the Director, Defense Logistics Agency Finance Aviation and the Commander, Defense Logistics Agency Aviation San Diego, develop standard operating procedures to identify, estimate, and document operating costs for providing supply storage and distribution support.**

### ***Deputy Director, Defense Logistics Agency Logistics Operations Comments***

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA Finance Aviation and the Commander, DLA Aviation San Diego, agreed with the recommendation. However, the Deputy Director indicated that FRCSW should be responsible for developing the standard operating procedures because material management cost was only a portion of the FRCSW's overall budget. The Deputy Director, stated the Comptroller, FRCSW is working with her counterparts in FRC East and FRC Southeast to develop a standard operating procedure that documented their operating costs for SS&D support and indicated that the standard operating procedure will be referenced in the agreement.

### ***Our Response***

The Deputy Director, DLA Logistics Operations comments were not responsive because proposed corrective actions did not meet the intent of the recommendation. The Deputy Director responded with corrective actions for FRCSW. However, he did not provide an appropriate response to explain how DLA Aviation Finance and DLA Aviation

San Diego would develop and document a standard operating procedure that would clearly identify, estimate, and document DLA Aviation San Diego operating costs for providing SS&D support. If DLA Aviation Finance and DLA Aviation San Diego developed standard operating procedures, DLA Aviation San Diego would have uniformity on the process for identifying, estimating, and documenting operating costs to provide SS&D support to FRCSW. Therefore, we request that the Deputy Director reconsider his position and provide additional comments that identify corrective actions and a time frame for completing corrective actions.

**3. We recommend the Director, Defense Logistics Agency Finance Aviation and the Commander, Defense Logistics Agency Aviation San Diego, establish a quality control process to review the operating costs assessed to the Fleet Readiness Center Southwest to prevent the inclusion of costs for services that are not directly or indirectly related to Defense Logistics Agency, Aviation San Diego providing supply, storage, and distribution support to the Fleet Readiness Center Southwest.**

### ***Deputy Director, Defense Logistics Agency Logistics Operations Comments***

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA Finance Aviation and the Commander, DLA Aviation San Diego, agreed with the recommendation. The Deputy Director stated the written guidance for the quality control process will be incorporated in the agreement identified in Recommendation 1 and adhered to by DLA Aviation San Diego during the annual budget preparation meeting.

### ***Our Response***

The Deputy Director, DLA Logistics Operations comments were not responsive because the Deputy Director did not meet the intent of the recommendation. A support agreement is not the proper vehicle to document an internal quality control process specific to DLA Aviation San Diego. The purpose of a support agreement is to define the support being provided by one supplier to one or more receivers, specify the basis for calculating the reimbursement charges for each service, and establish the billing and reimbursement process, not to replace a quality control process. DLA Finance Aviation and DLA Aviation San Diego should develop a quality control process independent of the support agreement because it is a separate process that will ensure that DLA Aviation San Diego does not provide services that are not directly or indirectly related to SS&D support. We request that the Deputy Director provide additional comments in response to the final report with corrective actions and the time frame for completing corrective actions.

**4. We recommend the Director, Defense Logistics Agency Finance Aviation and the Commander, Defense Logistics Agency Aviation San Diego, cease performing services outside the scope of supply, storage, and distribution support or that are not the responsibility of Defense Logistics Agency Aviation San Diego. Such services would include scheduling repairs and overhauls, bill of materials, and information systems support.**

## ***Deputy Director, Defense Logistics Agency Logistics Operations Comments***

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA Finance Aviation and the Commander, DLA Aviation San Diego, disagreed with the recommendation. The Deputy Director stated that DLA Aviation San Diego did not perform the services of scheduling repairs and overhauls, bill of material, and information systems support. The Deputy Director acknowledged that reallocating these costs from DLA Aviation San Diego would not reduce FRCSW operating cost, but rather change the way FRCSW accounts for these costs. The Deputy Director stated that DLA is coordinating with FRCSW comptroller to make adjustments for FY 2013 budget that would remove scheduling repairs and overhauls, bill of material, and information system support from FRCSW material recovery rate.

### ***Our Response***

The Deputy Director, DLA Logistics Operations comments were not responsive. The Deputy Director provided contradictory comments to the recommendation. Specifically, the Deputy Director stated that DLA Aviation San Diego did not perform the services of scheduling repairs and overhauls, bill of materials, or information technology support, but later stated that DLA would work to remove the cost associated with these services from their operating budget. Despite the Deputy Director's statement that DLA Aviation San Diego did not perform services outside of SS&D, our finding supported that DLA Aviation San Diego included the costs for services outside SS&D support in its operating budget or funded the contracts. Further, the Deputy Director's comments were unclear on whether DLA Aviation San Diego would remove the costs from its FY 2013 budget for services outside SS&D support or if the Deputy Director indicated that FRCSW would remove the costs from its budget for FY 2013. We request the Deputy Director, DLA Logistics Operations, provide clarifying comments that address corrective actions and identify a time frame for completing corrective actions.

## Appendix. Scope and Methodology

We conducted this performance audit from July 2010 through August 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We evaluated DLA Aviation San Diego's estimated operating costs assessed to FRCSW for providing supply, storage, and distribution support from FY 2009 through FY 2011. Specifically, we determined whether the estimated operating costs for labor and contract services were allowable (directly or indirectly related to providing supply, storage, and distribution support or not the responsibility of DLA Aviation San Diego) and supportable (amounts supported through sound estimating and documenting practices). In addition, we evaluated how DLA Aviation San Diego reimbursed its operating costs as well as how FRCSW cost centers were individually assessed their share of the DLA Aviation San Diego's operating costs.\*

During the course of the audit, we interviewed personnel from the following organizations:

- DLA Aviation, Richmond, Virginia;
- DLA Aviation San Diego, San Diego, California;
- DLA Strategic Program Executive Directorate personnel, Fort Belvoir, Virginia; and
- FRCSW San Diego, San Diego, California.

To gain an understanding of how the DLA Aviation San Diego cost estimate were developed and documented, we:

- identified and reviewed policies, procedures, and MOAs governing the relationship between DLA and FRCSW to determine services that would be the responsibility of DLA Aviation San Diego;
- collected, reviewed, and analyzed contracts, purchase orders, invoices, military interdepartmental purchase requests, and other funding documents associated with DLA Aviation San Diego operating costs to determine whether DLA Aviation San Diego was correctly assessing its operating costs;
- collected, reviewed, and analyzed personnel data, such as personnel rosters, employee annual salary rates, and annual cost of living data;
- identified and reviewed the methodologies, assumptions, and other factors used to develop the estimates for over 17 DLA Aviation San Diego cost categories;

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\* These surcharges are based on the material recovery rate, which is assessed by DLA associated with the FRCSW Cost Center's purchase orders.

- identified and reviewed the cost negotiation process between DLA Aviation San Diego and FRCSW to determine how FRCSW agreed to the annual reimbursable fixed price agreement for the SS&D support; and
- identified and reviewed current DLA initiatives related to the consolidation of SS&D services and inventories.

Once we gained an understanding of how the DLA Aviation San Diego cost estimate were developed and documented, we validated the cost category estimates by re-creating the estimate using the documentation, methodology, assumptions, and other factors identified by DLA Aviation San Diego personnel. As we re-created the cost category estimates, if the recreated cost estimate was within 15 percent, we determined the DLA Aviation San Diego cost category estimate to be valid. We used professional judgment and selected a threshold of 15 percent because documents, assumptions, and other cost factors related to DLA Aviation San Diego cost category estimates were not available or documented.

## Universe and Nonstatistical Sample Selection

From FY 2009 through FY 2011, the DLA Aviation San Diego estimated operating costs, valued at approximately \$70.1 million (over 42 cost categories per fiscal year) to provide SS&D support to FRCSW. We nonstatistically selected the cost categories with estimated cost of at least \$500,000. If the cost category estimate met the \$500,000 threshold for at least one of the 3 fiscal years, we evaluated the cost category for all 3 fiscal years. Therefore, we reviewed approximately \$59.3 million, which accounted for approximately 85 percent of DLA Aviation San Diego’s total operating costs from FY 2009 through FY 2011. The table below provides a breakdown, by fiscal year, of the operating cost that we reviewed.

**Table. DLA Aviation San Diego Operating Cost Evaluated  
(in millions)**

<b>Fiscal Year</b>	<b>Labor</b>	<b>Contractor Services</b>	<b>Total Operating Cost Evaluated</b>
2009	\$10.0	\$10.5	\$20.5
2010	9.8	9.2	19.0
2011	10.4	9.4	19.8
<b>Total</b>	<b>\$30.2</b>	<b>\$29.1</b>	<b>\$59.3</b>

## Use of Computer-Processed Data

We relied on computer-processed data extracted from the Defense Industrial Financial Management System and Integrate Data Environment. We validated the accuracy of the data extracted from the two systems with documentation from DLA Aviation San Diego and FRCSW containing the details for the actual material orders received and the actual MRR charged to FRCSW. We did not find significant errors between the computer-

processed data that would preclude use of the computer-processed data to meet the audit objectives or that would change the conclusion in this report.

### **Prior Coverage**

No prior coverage has been conducted on our audit topic during the last 5 years.

# Defense Logistics Agency Comments



DEFENSE LOGISTICS AGENCY  
HEADQUARTERS  
8725 JOHN J. KINGMAN ROAD  
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NOV 14 2011

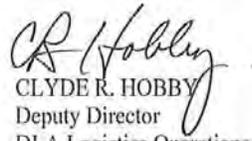
MEMORANDUM FOR DIRECTOR, OFFICE OF INSPECTOR GENERAL

SUBJECT: Response to Department of Defense Inspector General (DoD IG) Report:  
Improvements Needed With Identifying Operating Costs Assessed to the Fleet  
Readiness Center Southwest (Project No. D2010-D000LC-0248.000)

The attached is provided in response to DoD IG Report D2010-D000LC-0248.000. DLA non-concurs as written with Recommendation 1 and provides an alternative to capture and document the recommendation findings. DLA concurs with Recommendation 2 but the responsibility falls within Fleet Readiness Center Southwest (FRC-SW) to develop the information requested and provide the output to DLA. DLA concurs with Recommendation 3. DLA non-concurs as written with Recommendation 4 and provides justification.

DLA appreciates the opportunity to comment on the draft report. DLA is working together with FRC-SW to resolve the identified deficiencies. These actions will ensure the partnership details between DLA and FRC-SW are clearly defined.

Point of contact is [REDACTED]

  
CLYDE R. HOBBY  
Deputy Director  
DLA Logistics Operations

Attachment:  
As stated

## DRAFT REPORT

### Improvements Needed With Identifying Operating Costs Assessed to the Fleet Readiness Center Southwest

Project No. D2010-D000LC-0248.000

Dated: October 13, 2011

#### DoDIG Recommendations

We recommend that the Director, Defense Logistics Agency Finance Aviation and the Commander, Defense Logistics Agency Aviation San Diego:

**Recommendation 1:** Coordinate with the Comptroller, Fleet Readiness Center Southwest to develop and implement a local interservice support agreement to clearly define the Defense Logistics Agency Aviation San Diego roles and responsibilities; supply, storage, and distribution services to be performed; and cost associated with the agreed on services are clearly defined and agreed to.

**DLA Response:** Disagree as written. The purpose of an Inter-Service Support Agreement (ISSA) is to detail the specific Installation Support that a Base Host will provide to its Tenants. It is not intended to define, as indicated by the DoDIG, the supply storage and distribution services to be performed (in this case) between FRCSW and DLA Aviation San Diego as a result of the BRAC 2005 decisions. Those particular types of services should be documented in either a Memorandum of Agreement (MOA) or a Performance Based Agreement (PBA). Furthermore, these types of agreements are negotiated by the Director, DLA Customer Operations through his local Commander—in this case the Commander, DLA Aviation San Diego and would represent an agreement for support to be provided and received between the parties. The only portions of agreements negotiated by the DLA Finance Aviation are those that indicate the frequency of providing and billing reimbursable orders (Military Interdepartmental Purchase Requests, or MIPRs). We recommend that the appropriate Agreements be put in place to document the support being provided by both the FRCSW and the DLA Aviation San Diego organizations and that cost estimates be provided to and reviewed by the Director, DLA Aviation Customer Operations with assistance from the Director, DLA Finance Aviation for reasonableness and inclusion in the overall DLA Aviation Budget Submission.

**Recommendation 2:** Develop standard operating procedures to identify, estimate, and document operating costs for providing supply storage and distribution support.

**DLA Response:** Agree with Recommendation 2, but developing these standard operating procedures (buyer-seller reimbursable process) is the responsibility of the Fleet Readiness Center (FRC) because the material management cost is only a portion of the FRC's overall budget. FRC Southwest Comptroller is working with her counterparts in FRC East and FRC Southeast in developing a standardized SOP to document their operating costs for SS&D; this SOP will be referenced in the agreement from Recommendation 1.

**Recommendation 3:** Establish a quality control process to review the operating costs assessed to the Fleet Readiness Center Southwest to prevent the inclusion of costs for services that are not directly or indirectly related to Defense Logistics Agency, Aviation San Diego providing supply, storage, and distribution support to the Fleet Readiness Center Southwest.

**DLA Response:** Agree with Recommendation 3. The written guidance of the quality control process will be incorporated in the agreement from Recommendation 1 and adhered to during the annual budget preparation (buyer-seller) meeting between FRC Southwest and DLA Aviation San Diego.

**Recommendation 4:** Cease performing services outside the scope of supply, storage, and distribution support or that are not the responsibility of Defense Logistics Agency Aviation San Diego. Such services would include scheduling repairs and overhauls, bill of materials, and information systems support.

**DLA Response:** Disagree as written. DLA Aviation San Diego is not, and has not, performed the services of 1) scheduling repairs & overhauls (NTA- National Technologies Association), 2) bill of material (BOM), and 3) information systems support. These three categories of services account for \$17.6M in services during FY09-FY11; the same \$17.6M addressed in the Finding statement, "DLA Aviation San Diego officials assessed \$17.6 million in operating costs for services that were outside the scope of their SS&D responsibilities..." Reallocating the costs associated with these three services will not reduce the overall operating cost to FRC-SW, but merely transfer the requirement/function from FRC-SW Material cost (MRR) to FRC-SW Indirect (overhead) cost.

For the FY13 budget, we are coordinating with FRC-SW Comptroller to remove the associated cost of scheduling repairs & overhauls and BOM from FRC-SW's Material Recovery Rate; Information systems support will be limited to support of SS&D.

**\*\*PLEASE NOTE:** The DoDIG request you also comment on the internal control weaknesses discussed in the report on page 4.

**DLA Response:** We do not believe that this report and its findings reflect an internal control weakness on the part of the Director, DLA Finance Aviation (as discussed in responses to Recommendations 1 & 2). An ISSA is not the proper vehicle for identifying what services are to be performed between the Commander DLA Aviation San Diego and FRC-SW – it is an Installation Support Agreement that lays out the Base support provided by a host to its tenants. This includes fire protection, etc. A more appropriate agreement would be an MOA or PBA and would be negotiated by the Director, DLA Aviation Customer Operations through their field representative, the Commander, DLA Aviation San Diego. This would not be a responsibility of a financial organization as we are not operational in nature and would not know what services should or should not be provided within the BRAC decisions. As such, we would not put standard operating procedures in place for other than finance-related tasks such as frequency of providing and receiving reimbursable orders and billings against those orders as well as data calls for budget submission information as laid out by the OUSD(C).



# Inspector General Department of Defense

