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Acronyms

DCI	Data Collection Instrument
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
NAVSUP	Naval Supply Systems Command
OM&S	Operating Material & Supplies
PMW	Program Management Warfare
PP&E	Property, Plant, and Equipment
RRAM/VSOM	Realtime Reutilization Asset Management/Virtual Sponsor Owned Material
SFFAS	Statement of Federal Financial Accounting Standards
SIMS	Supply Inventory Management System
SOM	Sponsor Owned Material
SPAWAR	Space and Naval Warfare Systems Command
SSC	SPAWAR Systems Center



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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ARLINGTON, VIRGINIA 22202-4704

January 26, 2007

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT AND COMPTROLLER)
COMMANDER, SPACE AND NAVAL WARFARE
SYSTEMS COMMAND
NAVAL INSPECTOR GENERAL

SUBJECT: Report on Reporting of Navy Sponsor Owned Material Stored at the Space
and Naval Warfare Systems Centers (Project No. D2006-D000FJ-0130.000)
(Report No. D-2007-048)

We are providing this report for your information and use. We considered management comments on a draft of this report when preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. James L. Kornides at (614) 751-1400 extension 211 or Mr. John K. Issel at (614) 751-1400 extension 212. See Appendix B for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Paul J. Granetto", is positioned above the printed name.

Paul J. Granetto, CPA
Assistant Inspector General and Director
Defense Financial Auditing Service

Department of Defense Office of Inspector General

Report No. D-2007-048

January 26, 2007

Project No. D2006-D000FJ-0130.000

Reporting of Navy Sponsor Owned Material Stored at the Space and Naval Warfare Systems Centers

Executive Summary

Who Should Read This Report and Why? Navy personnel responsible for reporting the amount and value of Sponsor Owned Material stored at Navy facilities should read this report. This report discusses the control and reporting of Sponsor Owned Material stored at the Space and Naval Warfare Systems Centers.

Background. The Navy reported \$58.3 billion of Operating Materials and Supplies on the Balance Sheet of its financial statement at the end of the first quarter of FY 2006. Operating Materials and Supplies are tangible personal property consumed in normal operations. The Department of the Navy's Operating Materials and Supplies line item included a sub-category called Sponsor Owned Material. The Navy defines Sponsor Owned Material as material used in support of program manager mission requirements. Sponsor Owned Material is used for item fabrication, assembly, testing, manufacture, development, repair, or research and development. About \$1.14 billion of the Navy's Sponsor Owned Material is stored at the Space and Naval Warfare Systems Centers.

Results. The Space and Naval Warfare Systems Command did not accurately report the amount of its Sponsor Owned Material located at the Systems Centers. About \$130.7 million of the assets were either misclassified or overstated. Also, about \$84.1 million in assets not owned by Space and Naval Warfare Systems Centers were included in the amounts reported. (Finding A)

The Space and Naval Warfare Systems Command inventory controls did not ensure that Sponsor Owned Material were properly reported and updated in a timely manner. In addition, Sponsor Owned Material was being retained and stored beyond allowable time periods. (Finding B)

As a result of these conditions, the Space and Naval Warfare Systems Command was not in compliance with provisions of Statement of Federal Financial Accounting Standards No. 3 as it relates to Operating Materials and Supplies. The Navy also lacked total asset visibility over Sponsor Owned Material at the Space and Naval Warfare Systems Center Charleston.

During the course of the audit, the Space and Naval Warfare Systems Center Charleston and the Space and Naval Warfare Systems Center San Diego took some steps to correct the deficiencies found. However, additional steps were needed to fully correct the deficiencies. Space and Naval Warfare Systems Centers needed to perform a complete wall-to-wall inventory and analysis to properly identify and categorize all assets classified as Sponsor Owned Material. The Space and Naval Warfare Systems Center Charleston also needed to improve its total asset visibility program as it related to

material stored at its facility through the use of the Real Time Reutilization Asset Management/Virtual Sponsor Owned Material database. We also identified internal control weaknesses in the financial reporting of Sponsor Owned Material. The Space and Naval Warfare Systems Centers needed to establish consistent guidance on reporting Sponsor Owned Material that conforms with Federal accounting standards.

Management Comments. Comments from the Assistant Secretary of the Navy (Financial Management and Comptroller) were responsive. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred with all recommendations. In addition, the comments from the Commanding Officer, Space and Naval Warfare Systems Center San Diego, and the Commanding Officer, Space and Naval Warfare Systems Center Charleston were also responsive. The Commanding Officers, Space and Naval Warfare Systems Centers in San Diego and Charleston concurred with all recommendations. Therefore, no further comments are required.

See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

A Navy Sponsor Owned Material (SOM) Working Group report issued in May 1999 defined SOM as material used in support of a program manager's mission requirements for production, life cycle maintenance, and installation of systems and equipment consistent with the mission charter. The report indicated material usage may involve, but is not limited to, item fabrication, assembly, testing, manufacture, development, repair, or research and development.

SOM is reported as an asset on the Navy General Funds Balance Sheet as part of Operating Materials and Supplies (OM&S). In the first quarter of FY 2006, the Space and Naval Warfare Systems Command (SPAWAR) reported \$1.14 billion in SOM as OM&S held for use. It did not report any other category of OM&S.

Command Structure for SPAWAR. SPAWAR partners with three offices: the Program Executive Office C4I; the Program Executive Office Space Systems; and the Program Executive Office Enterprise Information Systems. Collectively, they deliver command, control, communications, and other services to the war fighter. SPAWAR consists of five program directorates: SPAWAR Systems Center (SSC) San Diego, California; SSC Charleston, South Carolina; SSC Norfolk, Virginia; SPAWAR Space Field Activity, Chantilly, Virginia; and SSC New Orleans, Louisiana. All SOM for SPAWAR is reported from SSC San Diego and SSC Charleston.

Data Collection Instrument. Naval commands report SOM through a Data Collection Instrument (DCI), which is a Navy Web-based system. DCI users at the reporting level enter their information each quarter and this information is consolidated at the command level.¹ The Assistant Secretary of the Navy (Financial Management and Comptroller) consolidates this information at the Navy level and provides it to the Defense Finance and Accounting Service for inclusion in the financial statements.

Space and Naval Warfare Systems Command Guidance. SPAWAR Instruction 4401.1F, "Policy for Receipt, Storage and Reporting of Repairable Project Material Held by SPAWAR Activities," May 8, 1995, provides policy for handling and reporting of Sponsor Owned Material located at SPAWAR activities.² This instruction applies to material acquired for use in the construction or development of equipment or systems for eventual installation at another activity, ship, or location. It states that all SPAWAR material, unless classified as plant or minor property, should be considered SOM. SOM may be assets that are repairable or consumable.

Inventory and Related Property. In the Statement of Federal Financial Accounting Standards (SFFAS) No. 3, "Accounting for Inventory and Related Property," October 27, 1993, issued by the Federal Accounting Standards Advisory Board, provided accounting principles for reporting OM&S. The

¹ The actual process may differ for each Naval command.

² SPAWAR use of the terms "project material" and "sponsor owned material" are synonymous.

standard requires that OM&S be reported as an asset on the Balance Sheet and be defined as tangible personal property to be consumed in normal operations. Also, the standard excludes the following assets from being reported as OM&S:

- goods that have been acquired for use in constructing real property or assembling equipment for the entity to use,
- stockpile materials,
- goods held under price stabilization programs,
- foreclosed property,
- seized and forfeited property, and
- inventory.

The standard requires OM&S to be categorized as:

- OM&S held for use,
- OM&S held in reserve for future use, or
- OM&S excess, obsolete, and unserviceable.

The standard also requires that once an OM&S asset is issued to an end user, it is to be expensed and removed from the Balance Sheet.

Property, Plant, and Equipment (PP&E). SFFAS No. 6, “Accounting for Property, Plant and Equipment,” June 1996, states that PP&E is defined as “tangible assets that (1) have a useful life of 2 or more years, (2) are not intended for sale in the ordinary course of business, and (3) are intended to be used or available for use by the entity.”

Objectives

The audit objective was to evaluate controls over the existence of SOM stored at SPAWAR locations. Specifically, we evaluated the financial reporting of material reported as SOM and the physical inventory control over the material. We also reviewed internal controls as they relate to the audit objective. See Appendix A for a discussion of the scope and methodology.

Review of Internal Controls

We identified internal control weaknesses for SPAWAR as defined by DoD Instruction 5010.40, “Managers Internal Control (MIC) Program Procedures,” January 4, 2006. SPAWAR did not have adequate internal controls over the

financial reporting and inventory management of SOM. Implementing Recommendations A.1.a., A.1.b., and A.2 of finding A and Recommendations B.1.a., B.1.b., and B.2. of finding B will improve the overall financial and inventory management controls. A copy of the final report will be provided to the senior official responsible for internal control in SPAWAR.

A. Financial Reporting of Sponsor Owned Material

SPAWAR did not accurately report its SOM. For the 152 judgmentally selected sample items reviewed³ and located at the SSC San Diego and SSC Charleston:

- Only 20 items, valued at \$1.5 million, were correctly reported as OM&S.
- The remaining 132 items, valued at \$103.6 million, should have been reported as PP&E. Of the 132 items, 5 items were overstated by \$27.1 million, and 79 items (valued at \$84.1 million) should have been reported by other major claimants or Federal agencies.

SPAWAR reported these assets incorrectly because it did not comply with guidance for financial reporting of assets. Also, SPAWAR categorized assets as OM&S that did not meet the reporting criteria. As a result, the reported value for OM&S on the Navy financial statements was overstated by at least \$130.7 million at the end of the first quarter FY 2006.

Process for Obtaining SOM Data by SPAWAR

To prepare Navy financial statements, the Assistant Secretary of the Navy (Financial Management and Comptroller) sends out requests each quarter through the Data Collection Instrument process for data on the value of items in the possession of SPAWAR. The SPAWAR comptroller forwards the request to SSC San Diego and SSC Charleston. SSC San Diego and SSC Charleston collect the data differently.

SSC San Diego Data Collection Process. At SSC San Diego, the inventory manager obtained data in two ways: electronically and manually. Usually, data were electronically pulled directly from the Supply Inventory Management System (SIMS). However, a number of branch offices in San Diego did not use or update the SIMS database. The inventory manager also had to request information from the branch offices respective databases through a manual extraction process and the branch offices did not always use a consistent pattern of respond to requests for capturing information manually.

SSC Charleston Data Collection Process. At SSC Charleston, the inventory manager extracted the data directly from its Inventory Suite database. This system tracked all assets considered SOM that was stored in four primary warehouses in Charleston, buildings 1602, 1636, 1637, and 1639.

³ The 152 sample items consisted of 104 items selected from SSC San Diego and SSC Charleston records for which we verified physical existence. The remaining 48 items were randomly selected off the warehouse floors and traced back to records.

Accuracy and Responsibility for Reporting SOM

SPAWAR reported \$84.1 million of SOM that should have been reported by other major claimants or Federal agencies. This occurred because SSC San Diego and SSC Charleston did not identify asset ownership and make a determination as to whether the asset met the criteria outlined in the SFFAS No. 3, “Accounting for Inventory and Related Property,” October 27, 1993, or SFFAS No. 6, “Accounting for Property, Plant and Equipment,” June 1996.

Ownership of the OM&S Sample Reviewed. Material located at SSC San Diego and SSC Charleston was owned by other program offices in various agencies that should have reported the material. Of the 152 total sample items reviewed at SSC San Diego and SSC Charleston, we were able to identify the owners of 149 of the line items. The ownership of the remaining 3 items could not be determined.

Table 1 shows the owners listed in the records for the sample items we reviewed.

Table 1. Asset Ownership

Owner	Number of Line Items	Dollar Value
SPAWAR	70	\$ 21,045,173
Naval Air Systems Command (NAVAIR)	24	40,535,252
Naval Sea Systems Command (NAVSEA)	15	34,353,224
Other Navy	18	4,866,044
Air Force	1	80,000
Marine Corps	12	1,468,380
Other Federal Agencies	8	2,781,860
Other DoD Agencies	1	5,000
Owner Not Determinable	3	5,220
TOTAL	152	\$105,140,153

Of the 152 sample items, at least 79 line items valued at \$84.1 million were assets for which SPAWAR was not the owner of the material. Rather, these assets belonged to NAVAIR, NAVSEA, and other Navy components or belonged to the Air Force, Marine Corps, other DoD agencies, or other Federal agencies.

Navy Instruction 7320.10A, “Department of the Navy Personal Property Policies and Procedures,” April 1, 2004, establishes the policies and procedures for General Fund and Working Capital Fund activities. SSC San Diego and SSC

Charleston were both Working Capital Fund activities. The Navy instruction explains that sponsor owned personal property is any property purchased by a major claimant and forwarded to a lower level. The Instruction states that the financial reporting of sponsor-owned personal property, including expenditures and depreciation, is the responsibility of the sponsor. Navy Working Capital Fund activities were only responsible for the accountability and performance of physical inventories for sponsor owned items.

Identification of the owner of assets was essential to ensure the accuracy of the Navy's financial reporting of SOM. Navy System Command management practices must include ensuring that each command reports the assets that it owns. The proper identification of the owner of the assets did not occur consistently at the SPAWAR System Command.

One illustration of the lack of proper ownership accountability of SOM was an item removed from the U.S.S. Yorktown, which was decommissioned in 2001. The item, a High Frequency Radio Group System from the ship, was sent to SSC Charleston where it was stored. The asset was the property of NAVSEA. SSC Charleston became the custodian of the asset, but was not the owner. If the asset had any residual value, the financial reporting should have been done by NAVSEA, rather than SSC Charleston. SSC Charleston should only be maintaining property accountability of the asset as the custodian.

Non-OM&S Assets. In addition to reporting assets that they did not own, SSC San Diego and SSC Charleston personnel improperly included non-OM&S assets in their financial reports. Of the 152 sample items reviewed, 132 non-OM&S items, valued at \$103.6 million, were reported as OM&S. This occurred because guidance used by SPAWAR to report its SOM was not consistent with the SFFAS No. 3. None of the assets would be considered consumable items as defined by the accounting standards for OM&S. Therefore, the items should have been classified as PP&E. Table 2 identifies examples of material that SPAWAR reported as OM&S.

Table 2. Non-OM&S Assets

Description	Value	Reporting Entity
Radio Receiver	\$ 46,451	SSC San Diego
Radome	80,246	SSC San Diego
Receiver/Transmitter	324,913	SSC San Diego
Radar Shelter W/7 Crates	8,700,000	SSC Charleston
Antenna System Test Set	437,580	SSC Charleston
ASR-8 Antenna System	869,800	SSC Charleston
High Frequency Radio Group System	\$2,500,000	SSC Charleston

SPAWAR Systems Command Comptroller personnel stated that they knew the reported value for SOM was inaccurate. They recognized the need to properly categorize their assets and took steps to improve the process. They stated that a new pilot program utilizing the Capital Asset Management System – Military Equipment will make the need to categorize and report SOM non-existent after

FY 2007. We disagree. The Systems Centers will still need to report SPAWAR sponsored material assets that meet the definition of OM&S to the SPAWAR Comptroller for inclusion in the overall Navy financial statements.

Data Input Errors. Five of the sample items reviewed had data input errors that resulted in a \$27.1 million overstatement of SOM in the financial reports. The input errors included High Frequency Radio Group System from the U.S.S. Yorktown, the decommissioned ship identified above, which was erroneously entered into SSC Charleston's Inventory Suite database eleven times at \$2.5 million for a total value reported of \$27.5 million. The error occurred because the Radio System was sent on 11 pallets and the data input clerk entered in the records at a value of \$2.5 million rather than recording \$2.5 million for the entire system. In another example, an erroneous value of \$1.4 million was entered into the system for a Hewlett Packard printer. Documentation showed the actual value of the printer was \$1,444.56.

Data Collection Instrument Updates.

The Assistant Secretary of the Navy (Financial Management and Comptroller) needed to update the DCI instructions. The guidance in place did not prevent inaccurate classification and categorization of assets by SSC San Diego and SSC Charleston. The guidance does not provide the commands with sufficient instructions to classify items as property, equipment, inventory, or operating materials and supplies. The guidance provides instructions for reporting sponsor owned materials as operating materials and supplies and does not specifically call for reviews of these items as other types of property or inventory. By providing additional guidance to ensure compliance with SFFAS No. 3 and SFFAS No. 6, SSC San Diego and SSC Charleston, financial reporting requirements should be enhanced.

Summary

Personnel at SSC San Diego and SSC Charleston recognized that the reporting of SOM was not accurate and have taken initial steps to improve the process. Until SPAWAR personnel are able to properly categorize the assets stored at their facilities and also determine specific ownership, SPAWAR financial reporting will continue to be inaccurate. The new systems may improve the process, but to ensure that the new systems perform properly, additional steps needed to be implemented. These include new guidance and the performance of a wall-to-wall inventory that identifies and properly categorizes all assets.

Recommendations and Management Comments

A.1. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center San Diego and the Commanding Officer, Space and Naval Warfare Systems Center Charleston:

- a. Perform a wall-to-wall inventory of all material stored at Space and Naval Warfare Systems Command locations to identify whether they should be classified as Operating Materials and Supplies, Property, Plant and Equipment, or Inventory. In addition, the wall-to-wall inventory should identify specific ownership of all assets.**
- b. Develop improved internal policies and procedures to comply with the Secretary of the Navy Instruction 7320.10A, "Department of the Navy Personal Property Policies and Procedures." At a minimum, the policies and procedures should ensure that the Space and Naval Warfare Systems Centers only report Sponsor Owned Material for which they have ownership.**

Commanding Officer, Space and Naval Warfare Systems Centers Comments. The Commanding Officers, Space and Naval Warfare Systems Centers San Diego and Charleston concurred. They agreed to perform the wall-to-wall inventories at all sites. They also agreed that the inventories will include properly classifying all material; validating asset ownership; and updating the dollar value of material and other assets as needed. The Commanding Officers also agreed to implement new business rules for the management of incoming material and to update internal policies to insure compliance with the Secretary of the Navy Instruction 7320.10A and other relevant Navy and DoD guidance.

A.2. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) revise the Data Collection Instrument instructions that will segregate Sponsor Owned Material into categories that comply with the Statement of Federal Financial Accounting Standards No. 3 and No. 6 to ensure that Sponsor Owned Material is properly categorized.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments. The Assistant Secretary of the Navy (Financial Management and Comptroller) concurred. The Assistant Secretary agreed to publish updated instructions for the Data Collection Instrument that will properly define the distinction between Operating Materials and Supplies and property, Plant, and Equipment for financial statement purposes. The Assistant Secretary also agreed to provide guidance to properly categorize assets.

B. Inventory Controls over Sponsor Owned Material

SPAWAR System Centers inventory controls did not always ensure accurate accountability for all SOM assets. Quantities for 17 of the 152 sample items we reviewed were not accurate. The errors had a value of \$35.7 million. Additionally, some SOM assets were retained and stored in excess of allowable time frames. Also, there was a lack of total asset visibility over SOM assets stored at SSC Charleston. These conditions occurred because SSC personnel used multiple inventory databases and did not update the primary inventory database used for inventory accountability and financial reporting in a timely manner. Additionally, Inventory Managers were not adhering to SPAWAR material retention policies. As a result, SPAWAR was not in compliance with provisions of the SFFAS No. 3 as it relates to OM&S.

Inventory Quantities for Assets Reported

Inventory controls were not adequate to ensure the existence and complete accountability for all assets classified as SOM. As part of our review, we selected a total of 152 sample items to verify existence and accuracy of reported quantities. Errors in quantities were found for 17 of the 152 sample items with the gross value of errors at \$35.7 million. Table 3 shows the errors disclosed during our physical verification of SOM asset existence.

Table 3. Quantity Discrepancies Found

Sample No.	Description	Qty. Per Records	Actual Quantity	\$ Value of Difference
CH-17	Ship Controller Station	1	0	\$ 1,131,535
CH-18	Ship Control	1	0	1,400,495
CH-27	Analysis Receiver	1	0	95,980
CH-38	Card Reader	63	1	328,024
CH-50	High Frequency Radio System	11	1	25,000,000
SD-01	Radio Receiver	15	11	185,804
SD-07	Leveler Circuit Card	3	0	3,358,788
SD-08	Radio Frequency Amplifier	12	4	1,852,832
SD-10	Communication. Group Cabinet	2	0	1,400,000
SD-19	Radar Dome	6	1	401,230
SD-20	Radar Dome Assembly	6	5	75,000
SD-23	Antenna Drive	14	3	235,521
SD-29	Circuit Card Assembly	2	1	77,156
SD-34	Vinten Pan/Tilt Head	8	6	24,000
SD-38	Terminal Control Unit	3	2	27,500
SD-42	Power Supply	1	0	67,880
SD-SUB 13	Klein Magnetron	5	2	Undeterminable ⁴
Total				\$ 35,661,745

The inaccurate quantities were caused by the use of multiple unrelated inventory systems, personnel not updating the primary inventory database used for inventory accountability and not reporting in a timely manner, and lack of resources.

Use of Multiple Inventory Systems. One primary reason for the discrepancies in reported quantities was that SSC San Diego and SSC Charleston did not comply with guidance directing the use of one inventory management system. According to SPAWAR Instruction 4401.1F, "Policy for Receipt, Storage and Reporting of Repairable Project Material Held by SPAWAR Activities," May 8, 1995, SPAWAR activities were required to implement a standard and centralized management system for all SOM received at an activity. However, data received from SSC San Diego and SSC Charleston indicated that the project offices used 21 different systems to manage their material. Furthermore, we found that of the 190 different project offices, 47 offices used two or more systems to keep track of assets. For the remaining 143 offices, 10 did not identify what system they used and 133 used one inventory management system. However, the offices did not necessarily use SIMS which was the system designated for financial reporting. This situation led to inadequate updating of

⁴ SSC San Diego personnel did not have pricing information in the system for the Klein Magnetron. Therefore, we were not able to determine a dollar value for the quantity discrepancy.

the systems used for financial reporting purposes by SSC San Diego and SSC Charleston.

Updating Reporting Systems. Infrequent updating the SOM inventory reporting systems by SPAWAR personnel contributed to a lack of inventory controls for SPAWAR. SSC San Diego used SIMS while SSC Charleston used a database called Inventory Suite to financially report SOM values to the Assistant Secretary of the Navy (Financial Management and Comptroller). In the 17 cases of discrepancies we identified, not updating one of the primary systems was a contributing factor in inaccurately reporting of SOM values. SSC San Diego personnel explained that their use of a system other than SIMS was based on the unique requirements of their sponsoring activity. However, in many cases, SIMS was not updated for several months to several years. One sample item selected for review at SSC San Diego was a pair of communication cabinets valued at \$700,000 each (sample SD-10). Neither item was located at SSC San Diego. Rather, the items had been transferred out in November 2003 and July 2004, respectively. In another instance at SSC Charleston, an Analysis Receiver (sample CH-27) valued at \$95,980 had been shipped on August 21, 2004, but remained on the records. These examples showed that the project offices did not update their reporting systems which resulted in inaccurate reporting of their SOM assets.

Utilization of Inventory Manager Resources. SSC San Diego assigned one person as the principle Inventory Manager responsible for multiple locations in San Diego, overseas in Japan and Guam, as well as in Philadelphia, Pennsylvania. The Inventory Manager stated that she relied on the project offices to keep track of their own material. The Inventory Manager acknowledged that because personnel did not have supply management backgrounds, or they lacked adequate training to update the SIMS database, the system was likely to contain inaccurate information.

Inventory Assets Not Reported

The Inventory Managers at both SSC San Diego and SSC Charleston did not report all SOM assets stored at their activities.

Inventory Manager Visibility Over SOM Assets at SSC Charleston. The Inventory Manager at SSC Charleston had visibility over assets stored in four warehouses and at an open field where larger assets were stored. The Inventory Manager did not have access to data on the SOM materials stored at the various project office warehouses or other areas. SSC Charleston provided a spreadsheet that identified 28 separate locations that were operated by various technical codes or sponsors. We visited 6 of the locations during our review and were informed that the materials stored at these locations were not reported to the Inventory Manager at SSC Charleston. The type of material stored at the locations varied but included some of the following assets:

- major end items,

-
- spares,
 - repair parts,
 - integration material,
 - consumables,
 - test equipment, and
 - interim support material.

One location we visited at SSC Charleston, Building T-29, operated by personnel from Project Code⁵ 09C and Project Code 71, contained assets valued at over \$5.1 million. The assets were not reported or accounted for by the Inventory Manager. A second location we visited, Building T-20, operated by personnel from Project Code 60, contained assets valued at over \$18 million. We noted that the SSC Charleston Inventory Manager did not account for or report them to SPAWAR.

Inventory Manager Visibility Over SOM Assets at SSC San Diego. The Inventory Manager at SSC San Diego only had responsibility for assets that were entered in the SIMS database. However, SSC San Diego project offices maintained separate databases. Our review of SSC San Diego inventories performed to determine the accuracy of the data in SIMS identified a significant breakdown of internal controls necessary to identify the existence of SOM assets. For example, the Inventory Manager performed an inventory between February 9, 2004, and February 17, 2004, on Project Code 2632 SOM assets. This inventory resulted in only a 67.85 percent accuracy rate in locating assets identified as SOM. The Inventory Managers report stated that one of the major reasons for the inaccuracies was that the inventory custodian for Project Code 2632 had no knowledge of where assets had been relocated. Also, the SIMS database for Project Code 2632 had never been updated. In total, the SSC San Diego database showed \$686.7 million of SOM assets. However, the amount of SOM assets reported by SSC San Diego for financial statement purposes totaled \$844.5 million. In an attempt to explain the \$157.8 million difference, SSC San Diego provided a spreadsheet that showed 16 of 41 project offices had not updated their SIMS database.

SOM Asset Retention and Storage

SSC San Diego and SSC Charleston retained and stored SOM assets beyond the completion of projects at the request of the program offices. The storage of these assets, with limited warehouse space at both activities, hampered the Inventory Managers ability to provide adequate resources for newer projects requiring storage of material. This condition occurred because the Systems Centers did not

⁵ SSC Charleston's offices that are considered laboratories and engineering facilities are called Project Codes.

follow established retention guidance requiring justification for storage of material between a projects life cycle.

SPAWAR Guidance on Material Retention. SPAWAR Instruction 4401.1F, “Policy for Receipt, Storage and Reporting of Repairable Project Material Held by SPAWAR Activities,” May 8, 1995, states:

Periodic inspections of SPAWAR activities reveal that material has been improperly directed from external activities (pushed) procured for installation subsequently cancelled or retained beyond the completion of a project. Much of this material held by SPAWAR activities is: (a) not properly identified; (b) beyond economical repair; (c) in unserviceable condition [e.g., Condition Code (F)] or (d) is obviously “junk.” This material is being retained for no valid or identifiable purpose. A need for full asset visibility, improved control, and accountability procedures for equipment held by SPAWAR activities has been recognized.

The observations and implied need for attention did not cause a change in practices. Our review disclosed the following:

- Line items (3,547), valued at \$32,869,569, were coded as Condition Code ‘F’ (unserviceable) in SSC San Diego’s overall universe. No action was taken on the assets and they were on record in their database and reported on the quarterly DCI.
- Assets (\$8,913,783) in the SSC San Diego universe were identified as “Excess, Obsolete, and Beyond Repair” (U.S. General Ledger Account Code 1513).
- Line items (1,247) stored at SSC Charleston had exceeded the established maximum retention period. These assets belonged to PMW 160 located at SPAWAR.
- Material stored in Building 1639 at SSC Charleston contained a heavy covering of dust and the white coverings were almost black and unrecognizable. When asked about the storage of these older assets, SSC Charleston personnel informed us that many program offices wanted to retain the assets in case there was a future need for them. However, SSC Charleston personnel believed that maintaining these older assets was creating a storage problem for newer programs that require storage space.

In addition, total asset visibility of SOM assets was lacking for SSC Charleston.

Total Asset Visibility. SSC Charleston was not in compliance with the provision of SPAWAR Instruction 4401.1F that required it to maintain total asset visibility. SSC Charleston did not provide total asset visibility for its SOM assets through the use of the Realtime Reutilization Asset Management/Virtual SOM (RRAM/VSOM) system. RRAM/VSOM is a system maintained by the Naval Supply Systems Command (NAVSUP). The purpose of the system was to provide on-line, real time visibility of selected material, such as SOM. VSOM was not managed by RRAM, in that it was a stand-alone database used for

visibility only. Control of inventory is the responsibility of an activity's local system. SSC San Diego and SSC Charleston maintain total control over the release of assets in the system. SSC San Diego personnel transferred all assets from the SIMS database on a daily basis to the RRAM/VSOM database. However, SSC Charleston only provided a limited number of its assets from its Inventory Suite database to the RRAM/VSOM database. For example, on October 1, 2006, SSC Charleston transferred 721 of its assets. In discussions with SSC Charleston and SSC San Diego personnel, we determined that there was a lack of consistency in reporting requirements between the two commands. Therefore, the System Commands will need to coordinate with NAVSUP to determine the proper reporting requirements for future transfers of data to the RRAM/VSOM database for accurate reporting.

Plans to Change SOM Inventory Operations

NAVSUP planned to assume inventory management operations at SSC Charleston and SSC San Diego beginning in FY 2008. The change is part of a Material Support Integration plan to consolidate material management and other Navy supply functions. NAVSUP plans to provide the following services when it assumes control:

- supervision and clerical support;
- control and processing of receipt documents;
- stock control and inventory accuracy;
- inspection and quality control;
- packaging, handling, storage, and transportation; and
- distribution, maintenance, and disposal.

Material ownership and management will not be transferred to NAVSUP, but will be retained by the sponsors. Also, inventory management personnel and process currently at the systems centers will remain the same. The program offices will be reviewed for transfer in Phase II of the change in inventory management.

Although the planned change in inventory management and supply operations by NAVSUP should improve the controls, several actions need to be taken during the transition. These actions include a full analysis of the material stored at all SPAWAR activities to determine the need to maintain the asset. In addition, SSC Charleston needed to interface with the RRAM/VSOM database to insure total asset visibility of all SOM assets. Because NAVSUP was assuming control of the supply management function in the future, we are not making recommendations related to the Inventory Manager functions.

Recommendations and Management Comments

B.1. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center San Diego and the Commanding Officer, Space and Naval Warfare Systems Center Charleston :

- a. Establish guidelines to ensure that all systems centers update the Supply Inventory Management System and the Inventory Suite database within one week of receipt, issue, or disposal of an asset.**

Commanding Officer, Space and Naval Warfare Systems Centers Comments. The Commanding Officers, Space and Naval Warfare Systems Centers San Diego and Charleston concurred. The Commanding Officers agreed to instruct all project offices and Space and Naval Warfare Systems Centers activities to update a centralized inventory management database within one week of occurrence.

- b. Require the program offices to provide justification for storing assets in the Space and Naval Warfare Systems Centers warehouses for programs no longer in operation.**

Commanding Officer, Space and Naval Warfare Systems Centers Comments. The Commanding Officers, Space and Naval Warfare Systems Centers San Diego and Charleston concurred. The Commanders will instruct all technical codes to obtain and maintain written justification for storing assets beyond project completion from owning sponsors.

B.2. We recommend that the Commander, Space and Naval Warfare Systems Center Charleston, require a weekly interface with the Realtime Reutilization Asset Management/Virtual Sponsor Owned Material database to improve total asset visibility.

Commanding Officer, Space and Naval Warfare Systems Center Charleston Comments. The Commanding Officer, Space and Naval Warfare Systems Center Charleston concurred. The Commanding Officer agreed to develop and implement procedures for timely and accurate update of the Realtime Reutilization Asset Management/Virtual Sponsor Owned Material database in accordance with the Naval Supply Systems Command business rules for total asset visibility.

Appendix A. Scope and Methodology

We performed the audit at the Space and Naval Warfare Systems Command (SPAWAR) Headquarters in San Diego, California, and at the Space and Naval Warfare System Centers (SSC) located in San Diego, California, and in Charleston, South Carolina, to evaluate the controls over the existence of Sponsor Owned Material (SOM). We conducted interviews and reviewed database files and inventory records maintained by SPAWAR, SSC San Diego, and SSC Charleston. We also reviewed DoD and Navy policies and regulations regarding responsibilities and procedures for the control over and financial reporting of Operating Materials and Supplies (OM&S). We judgmentally selected 152 items to perform record-to-floor and floor-to-record reviews to determine physical existence and record accuracy. The 152 sample items consisted of 104 items selected from SSC San Diego and SSC Charleston records for which we verified physical existence. The remaining 48 items were randomly selected off the warehouse floors and traced back to records.

We performed this audit from January 2006 through December 2006 in accordance with generally accepted government auditing standards.

Scope Limitation. We requested first quarter FY 2006 SOM data for our review. However, we did not, at first, obtain the correct database file for the first quarter from the System Centers. The database files did not match the total SOM reported by either SSC San Diego or Charleston in the first quarter Data Collection Instrument (DCI) report provided to the Assistant Secretary of the Navy (Financial Management and Comptroller). In subsequent attempts by the System Centers to provide the correct data, they were able to provide databases or documentation that more closely matched amounts reported on the DCI. The System Centers provided an explanation on the discrepancies that justified the difference between the first database provided and the DCI report. The inability to provide an exact match to the DCI report did not preclude us from performing the audit and did not have an impact on the results of the audit.

Use of Computer-Processed Data. We did not evaluate the general and application controls of the automated systems, although we used data produced by these systems to supplement the audit. We did not evaluate the controls over computer processed data because the objective of this audit was to review controls over the existence of Sponsor Owned Material for financial reporting. Not evaluating the controls over computer processed data did not affect the results of the audit.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD financial management and supply chain management high-risk areas.

Prior Coverage. No prior coverage has been conducted on Sponsor Owned Material within the Space and Naval Warfare System Center during the last 5 years.

Appendix B. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Director, Acquisition Resources and Analysis
Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director, Program Analysis and Evaluation

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Naval Inspector General
Auditor General, Department of the Navy
Commander, Space and Naval Warfare Systems Command
Commanding Officer, Space and Naval Warfare Systems Center San Diego
Commanding Officer, Space and Naval Warfare Systems Center Charleston

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform
House Subcommittee on National Security, Emerging Threats, and International Relations, Committee on Government Reform
House Subcommittee on Technology, Information Policy, Intergovernmental Relations, and the Census, Committee on Government Reform

Department of the Navy Comments



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(FINANCIAL MANAGEMENT AND COMPTROLLER)
1000 NAVY PENTAGON
WASHINGTON DC 20380-1000

7350.2
FMO
DEC 6 2006

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

Subj: DODIG DRAFT AUDIT REPORT ON ON NAVY SPONSOR OWNED
MATERIAL STORED AT THE SPACE AND NAVAL WARFARE
SYSTEMS CENTERS PROJECT NO. D2006-D000FJ-0130.000)

Ref: (a) DoDIG memo of 26 Oct 06

Encl: (1) Department of the Navy response to DoDIG Draft
Audit Report

By reference (a), you provided subject draft audit
report for review and comment. Enclosure (1) contains
responses to the findings and recommendations.

My point of contact for this draft audit is Ms. Beverly
Veit at (202) 685-6703, beverly.veit@navy.mil or Mr. Kyle
Fugate at (202) 685-6718, kyle.fugate@navy.mil

A handwritten signature in black ink, appearing to read "Mark E. Easton".

MARK E. EASTON
Director
Office of Financial Operations

DEPARTMENT OF THE NAVY
RESPONSE TO DODIG DRAFT AUDIT REPORT
ON NAVY SPONSOR OWNED MATERIAL STORED AT THE SPACE AND NAVAL
WARFARE SYSTEMS CENTERS
(Project No. D2006-D000FJ-0130.000)

Recommendation A.1. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center San Diego and the Commanding Officer, Space and Naval Warfare Systems Center Charleston:

a. Perform a wall-to-wall inventory of all material stored at Space and Naval Warfare Systems Command locations to identify whether they should be classified as Operating Materials and Supplies, Property, Plant and Equipment or Inventory. In addition, the wall-to-wall inventory should identify specific ownership of all assets.

Space and Naval Warfare Systems Center (SSC) San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: A wall-to-wall inventory of material and other assets stored at SSC San Diego storage locations will be conducted at all sites including Hawaii, Japan, Guam and Philadelphia. The inventory will include properly classifying material and other assets; validation of material and other asset ownership; and updating the dollar value (unit price) of the material and other assets, as needed. The inventory will be completed not later than 30 April 2008.

SSC Charleston Comments: A wall-to-wall inventory of material and other assets stored at SSC Charleston locations will be conducted to reclassify the material and other assets, as necessary; validate the actual material and other asset ownership; and update the dollar value of the material and other assets. Additionally, business rules will be implemented for management of incoming material and other assets. The inventory will be completed not later than 30 April 2008.

b. Develop improved internal policies and procedures to comply with the Secretary of the Navy Instruction 7320.10A, "Department of the Navy Personal Property Policies and Procedures." At a minimum, the policies and procedures should ensure that the Space and Naval Warfare Systems Centers only report Sponsor Owned Material for which they have ownership.

Enclosure (1)

SSC San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: SSC San Diego will support the Space and Naval Warfare Systems Command (SPAWAR) in its planned effort to update internal policies and procedures to ensure compliance with Secretary of the Navy Instruction 7320.10A and other relevant Navy and Department of Defense (DOD) guidance. SSC San Diego will determine if there is a continuing need for its instruction subsequent to the SPAWAR update and cancel or update it accordingly. The SPAWAR update is estimated to be complete by 30 June 2007. SSC San Diego internal policy and procedures update will be conducted thereafter and completed not later than 30 August 2007.

SSC Charleston Comments: SSC Charleston will support SPAWAR in its planned effort to update internal policies and procedures to ensure compliance with Secretary of the Navy Instruction 7320.10A and other relevant Navy and DOD guidance. The SPAWAR update is estimated to be complete by 30 June 2007. SSC Charleston internal policies and procedures will then be reviewed to ensure compliance with the Secretary of the Navy Instruction 7320.10A and other relevant Navy and Department of Defense (DOD) and guidance. The review of and any required modification to internal policies and procedures will be completed not later than 30 August 2007.

Recommendation A.2. We recommend that the Assistant Secretary of the Navy (Financial Management and Comptroller) revise the Data Collection Instrument instructions that will segregate Sponsor Owned Material into categories that comply with the Statement of Federal Financial Accounting Standards No. 3 and No. 6 to ensure the Sponsor Owned Material is properly categorized.

Assistant Secretary of the Navy (Financial Management and Comptroller) Comments: Concur.

Financial Management Operations (FMO) Comments: The FMO will publish updated DCI instructions that properly define Operating Materials and Supplies (OM&S) and General Property, Plant and Equipment (GPP&E) for financial reporting purposes and provide guidance and properly identifying the respective assets for correct categorization.

Recommendation B.1. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center San Diego and the

Commanding Officer, Space and Naval Warfare Systems Center
Charleston:

a. Establish guidelines to ensure that all systems centers update the Supply Inventory Management System and the Inventory Suite database within one week of receipt, issue, or disposal of an asset.

SSC San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: SSC San Diego will instruct all project offices, and will work with SPAWAR to establish and promulgate guidelines that will require all transactions to be updated in the centralized inventory management database within one week of occurrence. This action will be completed not later than 30 June 2007.

SSC Charleston Comments: SSC Charleston will work with SPAWAR to establish and promulgate guidelines that will require all transactions to be updated in the centralized inventory management database within one week of occurrence. This action will be completed not later than 30 June 2007.

b. Require the program offices to provide justification for storing assets in the Space and Naval Warfare Systems Centers warehouses for programs no longer in operation.

SSC San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: SSC San Diego will instruct all technical codes to obtain and retain a written justification from owning sponsors for storing assets beyond project completion. This action will be completed not later than 30 June 2007.

SSC Charleston Comments: SSC Charleston will instruct all technical codes to obtain a written justification from owning sponsors for storing assets beyond project completion. This action will be completed not later than 30 June 2007.

Recommendation B.2. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center Charleston, require a weekly interface with the Realtime Reutilization Asset Management/Virtual Sponsor Owned Material database to improve total asset visibility.

SSC Charleston Response: Concur.

SSC Charleston Comments: SSC Charleston will develop and implement procedures for timely and accurate update of the Realtime Reutilization Asset Management/Virtual Sponsor Owned Material database in accordance with Naval Supply Systems Command business rules. This effort will provide Total Asset Visibility for material in SSC Charleston's Command Storage and Technical Code Storage facilities. This action will be completed not later than 30 June 2007.

Space and Naval Warfare Systems Command Comments



DEPARTMENT OF THE NAVY
SPACE AND NAVAL WARFARE SYSTEMS COMMAND
4301 PACIFIC HIGHWAY
SAN DIEGO, CA 92110-3127

7502
Ser 00G/044
28 Nov 06

From: Commander, Space and Naval Warfare Systems Command
To: Inspector General, Department of Defense

Subj: RESPONSE TO DODIG DRAFT REPORT "REPORT OF NAVY
SPONSOR OWNED MATERIAL STORED AT THE SPACE AND NAVAL
WARFARE SYSTEMS CENTERS"

Ref: (a) DODIG Draft Report of 26 Oct 06 (Project No. D2006-
D000FJ-0130.000)

Encl: (1) Consolidated Response

1. This is the Space and Naval Warfare Systems Command consolidated response to reference (a). We have reviewed the draft report and provided our comments at enclosure (1).
2. Questions concerning this correspondence may be directed to Mr. John Gampel, Inspector General, at (619) 524-7065 or DSN 524-7065.

A handwritten signature in black ink, appearing to read "R. F. Smith", is positioned above the printed name and title.

R. F. SMITH
Deputy Commander

**Space and Naval Warfare Systems Center Charleston and Space and
Naval Warfare Systems Center San Diego Consolidated
Response to Department of Defense Inspector General (DODIG)
Draft Audit Report Project No. D2006-D000FJ-0130.000
"Reporting of Navy Sponsor Owned Material Stored at the Space
and Naval Warfare Systems Centers"**

Recommendation A.1. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center San Diego and the Commanding Officer, Space and Naval Warfare Systems Center Charleston:

a. Perform a wall-to-wall inventory of all material stored at Space and Naval Warfare Systems Command locations to identify whether they should be classified as Operating Materials and Supplies, Property, Plant and Equipment or Inventory. In addition, the wall-to-wall inventory should identify specific ownership of all assets.

Space and Naval Warfare Systems Center (SSC) San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: A wall-to-wall inventory of material and other assets stored at SSC San Diego storage locations will be conducted at all sites including Hawaii, Japan, Guam and Philadelphia. The inventory will include properly classifying material and other assets; validation of material and other asset ownership; and updating the dollar value (unit price) of the material and other assets, as needed. The inventory will be completed no later than 30 April 2008.

SSC Charleston Comments: A wall-to-wall inventory of material and other assets stored at SSC Charleston locations will be conducted to reclassify the material and other assets, as necessary; validate the actual material and other asset ownership; and update the dollar value of the material and other assets. Additionally, business rules will be implemented for management of incoming material and other assets. The inventory will be completed no later than 30 April 2008.

b. Develop improved internal policies and procedures to comply with the Secretary of the Navy Instruction 7320.10A, "Department of the Navy Personal Property Policies and Procedures." At a minimum, the policies and procedures should ensure that the Space and Naval Warfare Systems Centers only report Sponsor Owned Material for which they have ownership.

Enclosure (1)

SSC San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: SSC San Diego will support the Space and Naval Warfare Systems Command (SPAWAR) in its planned effort to update internal policies and procedures to ensure compliance with Secretary of the Navy Instruction 7320.10A and other relevant Navy and Department of Defense (DOD) guidance. SSC San Diego will determine if there is a continuing need for its instruction subsequent to the SPAWAR update and cancel or update it accordingly. The SPAWAR update is estimated to be complete by 30 June 2007. SSC San Diego internal policy and procedures update will be conducted thereafter and completed no later than 30 August 2007.

SSC Charleston Comments: SSC Charleston will support SPAWAR in its planned effort to update internal policies and procedures to ensure compliance with Secretary of the Navy Instruction 7320.10A and other relevant Navy and DOD guidance. The SPAWAR update is estimated to be complete by 30 June 2007. SSC Charleston internal policies and procedures will then be reviewed to ensure compliance with the Secretary of the Navy Instruction 7320.10A and other relevant Navy and Department of Defense (DOD) and guidance. The review of and any required modification to internal policies and procedures will be completed no later than 30 August 2007.

Recommendation B.1. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center San Diego and the Commanding Officer, Space and Naval Warfare Systems Center Charleston:

a. Establish guidelines to ensure that all systems centers update the Supply Inventory Management System and the Inventory Suite database within one week of receipt, issue, or disposal of an asset.

SSC San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: SSC San Diego will instruct all project offices, and will work with SPAWAR to establish and promulgate guidelines that will require all transactions to be updated in the centralized inventory management database within one week of occurrence. This action will be completed no later than 30 June 2007.

SSC Charleston Comments: SSC Charleston will work with SPAWAR to establish and promulgate guidelines that will require all transactions to be updated in the centralized inventory management database within one week of occurrence. This action will be completed no later than 30 June 2007.

b. Require the program offices to provide justification for storing assets in the Space and Naval Warfare Systems Centers warehouses for programs no longer in operation.

SSC San Diego and SSC Charleston Response: Concur.

SSC San Diego Comments: SSC San Diego will instruct all technical codes to obtain and retain a written justification from owning sponsors for storing assets beyond project completion. This action will be completed no later than 30 June 2007.

SSC Charleston Comments: SSC Charleston will instruct all technical codes to obtain a written justification from owning sponsors for storing assets beyond project completion. This action will be completed no later than 30 June 2007.

Recommendation B.2. We recommend that the Commanding Officer, Space and Naval Warfare Systems Center Charleston, require a weekly interface with the Realtime Reutilization Asset Management/Virtual Sponsor Owned Material database to improve total asset visibility.

SSC Charleston Response: Concur.

SSC Charleston Comments: SSC Charleston will develop and implement procedures for timely and accurate update of the Realtime Reutilization Asset Management/Virtual Sponsor Owned Material database in accordance with Naval Supply Systems Command business rules. This effort will provide Total Asset Visibility for material in SSC Charleston's Command Storage and Technical Code Storage facilities. This action will be completed no later than 30 June 2007.

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Defense Financial Auditing Service prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

Paul J. Granetto
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Inspector General Department of Defense

