

U.S. GENERAL ACCOUNTING OFFICE,  
DEFENSE ACCOUNTING AND AUDITING DIVISION,  
Washington, D.C., December 8, 1966.

Hon. PAUL R. IGNATIUS,  
*Assistant Secretary of Defense, Installations and Logistics.*

DEAR MR. IGNATIUS: Reference is made to your letter of June 17, 1966, commenting on our report to Congressman Thomas B. Curtis on the cost of sales of surplus property and disposition of proceeds (OSD Case #2430).

We were pleased to learn that as a result of our report you have initiated a Defense-wide audit of disposal activities which will cover in depth the issues raised in the report and provide a basis for corrective action as required. We will appreciate being advised of the results of your audit and of the corrective actions you take.

On August 31 and September 1, 1966, we discussed with representatives from your office and the Office of the Assistant Secretary of Defense (Comptroller) the matters covered in the report and commented on in your letter. These discussions were very helpful towards a mutual understanding of the presentations made in both the report and in the letter. As a result of these meetings, several practices in connection with the accounting for surplus sales proceeds and the reimbursing of disposal expenses should be brought to your attention for further consideration when corrective actions in the disposal area are being prescribed.

The two principal matters that have been discussed involve the withholding of scrap sales proceeds from the Deposit Fund Account by the Norfolk Naval Shipyard and the reimbursing from the Deposit Fund Account of scrap processing costs incurred by the shipyard. Regarding the withholding of proceeds, we, as well as the Disposal Program Manager (DSA), interpreted that portion of DOD Directive 7410.4 which states that—"Proceeds from sale of scrap shall be deposited to the industrial fund when such property is held in the industrial fund"—to mean that proceeds from "rip-out" materiel removed from vessels undergoing overhaul should be remitted to the Deposit Fund rather than to the Shipyard Industrial Fund. However, your letter and the recent discussions with Defense representatives indicated that such proceeds should be offset against specific customer orders to provide a more realistic determination of the costs of end-items and programs. The Norfolk Naval Shipyard did not follow this practice. Scrap sales proceeds are used to reduce general overhead charges applied to all types of shipyard work. Defense officials at our meetings indicated that such practice is not in accord with DOD policy.

We understand that when "rip-out" materiel cannot be identified to specific customer orders, it is permissible to use the proceeds to reduce overhead expenses. It would seem, though, that this latter practice would be followed only in cases where minor quantities of "rip-out" materiel are involved instead of the instances we reported. We believe that with the intimate knowledge that the Shipyard must have as to what must be done to accomplish specific work assignments, it is feasible for the Shipyard to identify and estimate the extent of "rip-out" materiel that will be generated, and estimate the corresponding cost reductions that can be made to customer orders. Therefore, we suggest that you consider having the Norfolk Naval Shipyard revise its current practice of routinely treating the sales proceeds from "rip-out" materiel as a reduction in general overhead costs of the shipyard.

With regard to reimbursing the Shipyard from the Deposit Fund for cost of processing scrap materiel for which sales proceeds were retained by the Shipyard, we understand from our recent meetings with Defense officials that it is DOD policy to have the Industrial Fund bear an equitable portion of the total cost incurred in realizing scrap sales proceeds. This is the position expressed in our report. The Shipyard, while retaining net proceeds from scrap sales of more than \$657,000 during fiscal year 1965, did not bear any of the scrap preparation costs which totaled more than \$325,000. The 10 percent retained from sales proceeds by the Defense Surplus Sales Office for the Deposit Fund covers only the estimated selling expenses of that organization rather than the scrap preparation costs of the Shipyard.

Since we have learned that the Shipyard Industrial Fund is permitted to retain proceeds from "rip-out" materiel for the purpose of crediting customer ac-