



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

REPORT
NO. 93-007

October 19, 1992

MEMORANDUM FOR THE DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Quick-Reaction Report on Termination of Procurement
of Coveralls (Project No. 1LE-0067.02)

Introduction

As part of our Audit of Contract Terminations at DoD Wholesale Inventory Control Activities (Project No. 1LE-0067), we reviewed the termination decisions by the Defense Personnel Support Center (DPSC) on procurements of Toxicological Agent Protective (TAP) coveralls. One of the overall objectives of the audit was to determine whether contracts were curtailed in response to decreased requirements for materiel stocked in the DoD wholesale supply system.

Our review of the decision not to terminate excessive quantities of TAP coveralls showed that the decision was not adequately supported. Terminating the excessive quantities on Contract DLA100-91-C-0349 would allow the Defense Logistics Agency to avoid costs associated with buying and holding about \$2.8 million of coveralls that exceed reasonable inventory levels and assist in the accomplishment of the DoD Inventory Reduction Program.

Scope of Audit

We reviewed DPSC records covering the period July 1990 through August 1992 documenting the procurement of the coveralls. We reviewed the Standard Automated Materiel Management System's (SAMMS) forecasted requirements and discussed the procurement of the coveralls with DPSC officials and personnel in the Defense Contract Management Area Office, Atlanta, and the U.S. Army Natick Research, Development and Engineering Center. We did not review internal controls related to our objective because of the time sensitivity of the data under review. This portion of the audit was made from April through August 1992 in accordance with auditing standards issued by the Comptroller General of the United States for economy and efficiency audits, as implemented by the Inspector General, DoD. Activities visited or contacted during the audit are listed in Enclosure 2.

Background

In 1990, DoD introduced an Inventory Reduction Plan to resize its inventory of secondary items. An integral part of the plan was to reduce purchases, including quantities on contract,

that exceed new requirements. To realize economic benefits and avoid inventory buildups, new requirements, especially diminishing requirements, must be recognized and acted upon promptly.

The DPSC procures wholesale inventory based on requirements computed by SAMMS. The requirements are based on historic demands and programmed future needs for an item. When forecasted requirements change from those estimated at the time of procurement, some quantities on order may become unnecessary. To avoid buying unneeded supplies, SAMMS generates a monthly due-in report showing potential excess materiel that is on order. When it is in the Government's best interest, item managers are to initiate and procurement personnel are to process termination actions to reduce or eliminate on order excess.

In August 1990, DPSC awarded Contract DLA100-91-C-0349 for 10,000 pairs of TAP coveralls and in October 1991, exercised an option to buy another 10,000 pairs. Those contract quantities were based on DPSC's forecasts of substantial future requirements but the requirements did not materialize as expected.

In January 1992, SAMMS identified excessive quantities of TAP coveralls due-in on Contract DLA100-91-C-0349. At that time, the item manager took no action to reduce the excessive quantities due-in. However, in April 1992, when we questioned the support for this decision, the item manager requested the procurement organization at DPSC to terminate the following excessive quantities of the coveralls.

Excessive Quantities of TAP Coveralls

<u>National Stock</u> <u>Number (NSN)</u>	<u>Size</u>	<u>Quantity</u>	<u>Value</u>
8415-00-099-6962	Small	1,550	\$ 587,310
8415-00-099-6968	Medium	5,140	1,947,597
8415-00-099-6970	Large	<u>3,660</u>	<u>1,386,811</u>
Total		<u>10,350</u>	<u>\$3,921,718</u>

In June 1992, DPSC procurement personnel decided not to pursue termination of the excessive quantities of TAP coveralls on order. Again, we found no reasonable basis for continuing the procurement of the excessive quantities and in a June 17, 1992, memorandum to the Commander, DPSC, we requested that DPSC terminate the purchase of excessive quantities or justify the decision to continue purchase. In response, DPSC advised us that the purchase of excessive coveralls would not be terminated and provided some rationale for continuing their acquisition. We consider the rationale inadequate.

Discussion

The quantity of TAP coveralls on contract was excessive based on forecasted requirements and the decision not to terminate the excessive quantities was not justified. We estimate that continuation of procurement will result in the unnecessary acquisition of about 7,000 pairs of TAP coveralls valued at about \$2.8 million and add to DoD's problem of excessive inventory.

Justification for continued purchase. In response to our memorandum of June 17, 1992, DPSC replied that it was in complete agreement that the coveralls were excess and that efforts to reduce active duty personnel and the many base closings in the European theater diminished the need for the TAP items. However, DPSC said that termination of the excessive quantities would not be prudent because of costs associated with termination, and the problems associated with production of and sole source (there is only one approved source for the items) of TAP items.

Upon receipt of DPSC's response, we again reviewed requirements and inventory position for the three principal sizes of TAP coveralls. The inventory on hand and due-in from the cited contract continued to be substantially more than requirements, based on the following demands.

Coverall Size and NSN	Average Quarterly Demands ^{1/} as of		Inventory On Hand and Due-in on Contract ^{2/}		
	Jan. 1992	Aug. 1992	Total Qty.	Excessive Requirements Qty. ^{3/}	Value ^{4/}
Small					
8415-00-099-6962	120	104	3,223	2,278	\$ 844,546
Medium					
8415-00-099-6968	282	187	8,552	6,848	2,538,827
Large					
8415-00-099-6970	286	224	<u>7,046</u>	<u>5,021</u>	<u>1,861,485</u>
Total			<u>18,821</u>	<u>14,147</u>	<u>\$5,244,858</u>

^{1/} Based on total demands in previous four quarters and without reductions for nonrecurring demands or customer returns.

^{2/} As of review in August 1992.

^{3/} Derived by computing requirements objective based on average quarterly demands, lead times as of August 1992, and a procurement cycle of 6 months for each item.

^{4/} Based on average contract price for initial and option quantities.

DPSC's rationale for continuing the purchase of excessive quantities of coveralls seemed plausible. However, DPSC did not have cost data to conclude that termination action was not economical and we do not believe that the other criteria, such as single source, warranted the continued delivery of all 20,000 pairs into the DoD inventory. The cognizant Defense Contract Management Area Office, Atlanta, advised us that it had not obtained or provided DPSC estimated contract termination cost, and that as of July 28, 1992, the contractor had not started production on 7,323 pairs of the 20,000 pairs of coveralls on the contract. Regarding the single source, the cognizant engineering activity for the coveralls, the U.S. Army Natick Research, Development and Engineering Center, advised us that in October 1993 it is scheduled to start development of new specifications for TAP coveralls to allow more producers to make the item. If DPSC took delivery of all the coveralls still due-in as of August 1992 on the cited contract, it would have enough inventory to last until 1999 or 2003 (depending on size), based on the average demand rates for the four most recent quarters. The TAP coveralls have a 3-year shelf life, and therefore, at least part of the excessive quantities on contract probably will end up in disposal.

Summary

The demand rate for the coveralls has been declining and coveralls are shelf-life items; therefore, continuing the purchase of at least 7,000 pairs of coveralls valued at \$2.8 million would not be a benefit to the Government. The risk of premature investment and obsolescence is clear; but the benefits of continuation of procurement are not. In a recent letter to another contractor on termination, the Commander of DPSC pointed out, "... Congress has mandated that the Department of Defense reduce its inventory levels whenever feasible."

We believe that termination of excessive quantities on the coveralls contract represents another opportunity for DPSC to satisfy the mandate and assist in achieving the objectives of DoD's Inventory Reduction Plan.

Recommendation for Corrective Action

We recommend that the Commander, Defense Personnel Support Center, take immediate action to determine the economic feasibility of terminating the excessive quantities of TAP coveralls due-in on Contract DLA100-91-C-0349 and terminate the appropriate quantities.

Management Comments

The DPSC was provided a copy of the draft report on September 14, 1992, but had not provided a response as of October 13, 1992. We request that the DPSC provide comments to this final report by November 3, 1992. The comments should indicate concurrence or nonconcurrence with the finding, recommendation, and the monetary benefits (see Enclosure 3), as required by DoD Directive 7650.3.

The courtesies and cooperation extended to the audit staff are appreciated. The audit team members are listed in Enclosure 3. If you have any questions regarding this quick-reaction report, please contact Mr. James Helfrich, Program Director, or Mr. John Issel, Project Manager, at (614) 692-4141 (DSN 850-4141). Copies of this final report will be distributed to the activities listed in Enclosure 4.



Edward R. Jones
Deputy Assistant Inspector General
for Audit

Enclosures

SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

<u>Recommendation Reference</u>	<u>Description of Benefits</u>	<u>Amount and/or Type of Benefit</u>
Recommendation	<u>Economy and Efficiency.</u> Improve operations by avoiding premature or unnecessary investments in wholesale inventory.	<u>Funds Put to Better Use.</u> The report identifies \$2.8 million in quantifiable monetary benefits. There may be some offsetting costs involved in the termina- tion of the excessive due-in quantities on contract. However, these costs have not been quantified. Benefiting fund will be the DLA stock fund.

ACTIVITIES VISITED OR CONTACTED

Headquarters, Defense Logistics Agency, Washington, DC
Defense Personnel Support Center, Philadelphia, PA
Army Natick Research, Development and Engineering Center,
Natick, MA
Defense Contract Management Area Office, Atlanta, GA

LIST OF AUDIT TEAM MEMBERS

Shelton R. Young, Director, Logistics Support Directorate
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