Audit Report

OFFICE OF THE INSPECTOR GENERAL

MATERIEL RETENTION AND DISPOSAL PROCEDURES FOR SECONDARY ITEMS

Report No. 94-070 March 28, 1994

Department of Defense

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Acronyms

AFMC	Air Force Materiel Command
DLA	Defense Logistics Agency
DRMS	Defense Reutilization and Marketing Service

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

March 28, 1994

MEMORANDUM FOR ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE LOGISTICS AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit Report on Materiel Retention and Disposal Procedures for Secondary Items (Report No. 94-070)

We are providing this report for your review and comments. It discusses the materiel retention and disposal procedures under current DoD and DoD Component policies for secondary items and an evaluation of the effectiveness of related actions taken under the DoD Inventory Reduction Plan. It also follows up on selected recommendations made in previous audit reports. Except for the Navy, which did not respond to the draft report, comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Assistant Secretary of the Navy (Financial Management) must provide final comments on the unresolved recommendations by May 27, 1994. Additional comments, including concurrence or nonconcurrence with the internal control weaknesses, are requested from the Army, Air Force and Defense Logistics Agency for Recommendation 1., from the Air Force for Recommendation 3., from the Army and Air Force for Recommendation 4., and from the Army for Recommendation 5. Additionally, the Defense Logistics Agency should provide the rationale for the nonconcurrence with the reported internal control weaknesses.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Charles F. Hoeger or Mr. Bernard J. Siegel at (215) 737-3881 (DSN 444-3881). The distribution of this report is in Appendix G. The audit team members are listed inside the back cover.

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Office of the Inspector General, DoD

Report No. 94-070 **March 28, 1994**
(Project No. 2LD-0047)

MATERIEL RETENTION AND DISPOSAL PROCEDURES FOR SECONDARY ITEMS

EXECUTIVE SUMMARY

Introduction. DoD policies and procedures require that unrequired and inactive inventory be reviewed to determine whether the materiel should be retained as economic or contingency stock or whether disposal action is appropriate. DoD Components compute their requirements and identify inactive inventory either quarterly or semiannually.

Objectives. The objectives of the audit were to determine if DoD Components were complying with DoD materiel retention and disposal policies for secondary items, to evaluate the effectiveness of related actions taken under the DoD Inventory Reduction Plan, and to evaluate corrective actions taken in response to previous audit reports.

Audit Results. DoD Components have taken aggressive action to reduce inactive and unrequired inventory. However, wholesale supply activities did not review and validate major segments of materiel categorized as potential reutilization and disposal materiel, contingency and numeric retention stocks, and materiel that did not support active weapons systems and was held for foreign military requisitioners only. Additionally, materiel was recouped from the disposal system when there was no requirement for the materiel.

For the wholesale supply activities we visited, we estimated that $522 million, of a universe of $6.9 billion, of potential reutilization and disposal materiel; $560 million, of a universe of $3.7 billion, of contingency retention stock; and $484 million, of a universe of $765.2 million, of numeric retention stock were unneeded materiel above the approved acquisition objective. The items were retained when there was either no requirement or significantly reduced requirement. Materiel was often obsolete, but still retained. Conversely, we estimated that $6.4 million of unneeded materiel was pulled back from disposal when there was no known need.

Internal Controls. Internal controls were either not established or not effective to ensure that unrequired and inactive inventory were reviewed for retention or disposal. Part I contains information on the controls assessed and Part II contains details on the material weaknesses.

Potential Benefits. This report does not claim any quantifiable monetary benefits (see Appendix E). However, potential benefits include compliance with materiel retention and disposal procedures, elimination of unneeded materiel, and decreased storage requirements.

Summary of Recommendations. We recommended that DoD Components consistently and routinely review all line items with potential reutilization and disposal materiel, promptly reclassify materiel that is retained, and dispose of materiel that is obsolete and unneeded; that contingency retention stock be validated and documented; that materiel held for foreign military customers be disposed of, when no longer needed, in accordance with DoD regulation; and that all automated recoupment decisions be reviewed before the actual recoupment process.

Management Comments. Comments were not received from the Assistant Secretary of the Navy (Financial Management). Although the Army, Air Force, and Defense Logistics Agency generally concurred with the recommendations there are some open issues. A discussion of the responsiveness of management comments is in Part II of the report. The complete text of management comments is in Part IV of the report.

Audit Response. We request that the Navy provide comments to the final report in accordance with DoD Directive 7650.3 and that the Army, Air Force, and Defense Logistics Agency provide additional comments on the unresolved issues by May 27, 1994.

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This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, Department of Defense.

Part I - Introduction

Background

DoD's wholesale inventories of secondary items, based on standard price, more than doubled from less than $44 billion in 1980 to approximately $110 billion in 1989. About $34 billion of the 1989 inventory was unrequired and inactive inventory. Inactive inventory and other terminology used in the report are defined in the glossary (Appendix A). Based on the growth in inventory and the value of inactive inventory and other identified problems in inventory management, congressional critics suggested that DoD was buying the wrong items and was ineffectively managing the existing inventory.

In July 1984, the then Assistant Secretary of Defense (Manpower, Installations, and Logistics) imposed a DoD-wide stock disposal moratorium to preclude the concurrent disposal and reprocurement of the same items as reported in Air Force, General Accounting Office, and other inspection and audit reports. For example, an Air Force inspection report showed that some inappropriate disposal decisions were initiated based on a computer program and were not reviewed by supply personnel. Automated disposals without supply personnel's review resulted in concurrent disposal and procurement of some items. In November 1985, the then Assistant Secretary of Defense (Production and Logistics) revised DoD Directive 4100.37, "Retention and Transfer of Materiel Assets," requiring that serviceable or economically repairable assets that have application to a weapons system in active use by U.S. Forces be retained subject to shelf-life and storage limitations. Those policies contributed to the retention and growth of unrequired and inactive inventory.

In March 1990, several congressional committees, including the Senate Committee on Governmental Affairs; the House Subcommittee on Defense, Committee on Appropriations; and the House Committee on Armed Services, held hearings addressing the growth of inactive inventory in the DoD supply system. A General Accounting Office report, cited in the hearings, showed that the Air Force and Navy inventory of inapplicable aircraft parts grew from $3.5 billion in 1980 to $13 billion in 1988. This represented about one-third of DoD's aircraft parts inventory. In May 1990, DoD initiated the Inventory Reduction Plan to improve logistics operations in DoD, reduce inventories, and achieve economies in supply operations. Concurrently, in June 1990, a policy memorandum was issued to allow the excessing of active items that did not support known requirements. After the disposal moratorium was lifted, reductions in inventory levels began.

In FY 1991, DoD began revaluing supply system inventories in conformance with the Comptroller of the DoD financial statement methodology. This required downward adjustments to reported supply system inventories based on the latest acquisition cost; reductions for materiel in need of repair, to exclude repair cost; and reductions for materiel categorized as potential reutilization and disposal to anticipated market prices (less than 2.5 percent of acquisition cost).

DoD Components have taken aggressive action to reduce inactive and unrequired inventory as a result of Inventory Reduction Plan initiatives. In FY 1991, wholesale supply activities turned in $5.4 billion (standard price) of inactive and unrequired materiel. This increased to $13.4 billion in FY 1992 and $25.4 billion in FY 1993.

As of September 30, 1992, DoD inventories of secondary items, based on latest acquisition cost, totaled at least $93 billion. (We were unable to identify the repair cost for materiel in need of repair.) After revaluation, the DoD reported value of secondary items was $80.2 billion.

Objectives

The objectives of the audit were to:

- Determine if DoD Components were complying with DoD materiel retention and disposal policies for secondary items,

- Evaluate the effectiveness of related actions taken under the DoD Inventory Reduction Plan, and

- Evaluate the corrective actions taken in response to prior audit reports.

Scope and Methodology

We reviewed DoD, the Services, and Defense Logistics Agency (DLA) policies and the standard implementing procedures relating to the review of inactive inventory and the procedures used in decisions to retain needed assets or dispose of excess assets. We discussed the rationale used to retain or dispose of an item with inventory item managers and equipment specialists for the sample items reviewed.

We did not specifically determine whether all recommendations from previous reports were fully implemented because of changes in DoD policies and the implementation of the Inventory Reduction Plan. DoD Components implemented these initiatives in an effort to achieve significant inventory reductions in line with the overall reduction of DoD requirements. Although the initiatives addressed several of the previous conditions and recommendations, some of the conditions still existed during our review and are discussed in Part II of this report.

Universe and Sample. As shown in the following Table, DoD inventories for secondary items, at the latest acquisition cost, were $97 billion in 1991 and $93 billion in 1992. Unrequired and inactive inventory were approximately $30.2 billion in 1991 and $30 billion in 1992, more than 30 percent of total assets on hand and on order.

Table. Total Supply System Inventory of Secondary Items (Latest Acquisition Cost - Billion)

Stock Level	Sept. 30, 1991	Sept. 30, 1992
· Approved Acquisition Objective	$61.0	$57.5
· In-Transit	5.8	5.5
·· Required or Active Inventory	66.8	63.0
· Economic Retention	13.8	12.9
· Contingency and Numeric Retention	7.3	4.0
· Potential Reutilization and Disposal*	9.1	13.1
·· Unrequired and Inactive Inventory	30.2	30.0
Total	$97.0	$93.0

*The DoD Supply System Inventory Report reported the value of potential reutilization and disposal at salvage prices of $0.2 billion in 1991 and $0.3 billion in 1992. We were unable to identify the repair cost for materiel in need of repair. The repair cost would increase all reported levels in the Table above except potential reutilization and disposal materiel.

We judgmentally selected eight wholesale supply activities (two each from the Army, Navy, Air Force, and DLA) and obtained selected stratification data from the DoD Components' data files. Each quarter DoD Components stratify the total inventory on hand to appropriate requirement and retention levels to identify any requirement deficiencies or potential inventory excesses. The stratification files identified each national stock number (hereafter referred to as line item) and the quantity and value of materiel allocated to each stratification level. The reliability of the data was not evaluated. Unless otherwise noted, data presented in this report represent only the eight wholesale supply activities reviewed.

We selected a stratified random sample of items identified in the stratification files as either contingency retention, numeric retention (Air Force only), or potential reutilization and disposal stocks. We reviewed the procedures used by inventory item managers and equipment specialists to validate retention levels and make appropriate retention or disposal decisions. Air Force and Navy samples were selected from the March 1992 stratification data file, Army samples were selected from the June 1992 and September 1992 stratification data files, and DLA samples were selected from the September 1992 stratification data file.

We obtained disposal and recoupment data from the Defense Reutilization and Marketing Service (DRMS) data file for the first half of FY 1992. During this

period, the eight wholesale supply activities initiated 77,648 disposal transactions valued at approximately $1.8 billion and 2,594 recoupment transactions valued at approximately $33.1 million. We selected a stratified random sample of disposal transactions to determine the validity of the disposal transactions and a random sample of recoupment transactions. Appendix B describes the audit site selection, audit sample methodology, and projections.

Audit Period, Standards, and Locations. We performed this economy and efficiency audit from May 1992 to April 1993 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly we included tests of internal controls as were considered necessary. Appendix F lists the organizations visited or contacted during the audit.

Internal Controls

Controls Assessed. We evaluated internal controls applicable to regulations and procedures that DoD Components used to identify unrequired and inactive inventory (economic retention, contingency retention, and potential reutilization and disposal assets) for routine disposal and retention reviews, and other one-time reviews. Additionally, we assessed the adequacy of the procedures used by the inventory item managers and equipment specialists to review items identified for retention or disposal decisions.

Internal Control Weaknesses. The audit disclosed internal control weaknesses as defined by Office of Management and Budget Circular A-123 and DoD Directive 5010.38. We also evaluated the process by which the DoD Components implemented the DoD Internal Management Control Program as it relates to the retention and disposal of secondary items. Internal controls were not adequate to ensure that DoD Components reviewed and validated for retention or disposal all potential reutilization and disposal materiel, contingency and numeric retention stocks, and materiel that did not support active weapons systems and was held for foreign military requisitioners only. In some instances, the reviews that were performed were inadequate especially when there was limited or no need for the materiel. Additionally, automated recoupment programs were not adequate to preclude the recoupment of unneeded materiel.

Recommendations 1.b., 3.b., 4., and 5. in this report, if implemented, will correct the internal control weaknesses. No quantifiable monetary benefits were associated with those recommendations. A copy of the final report will be provided to the senior officials responsible for internal controls within the Army, Navy, Air Force, and DLA.

Prior Audits and Other Reviews

During the last 5 years, several audit reports relating to the retention and disposal of secondary items were issued by the Inspector General, DoD; General Accounting Office; and the Military Departments' audit agencies. Each report evaluated the management controls used to identify unrequired and inactive inventory and the procedures that inventory item managers used to make appropriate retention and disposal decisions. Materiel reviewed included obsolete and inactive stock, program manager-owned stock, contingency retention stock (including former numeric retention stock), and materiel held for foreign military customers.

The audit reports generally showed that DoD Components did not have adequate management systems to identify all unrequired and inactive inventory and did not always make appropriate retention and disposal decisions. Appendix C summarizes the prior audit reports reviewed.

Other Matters of Interest

In early 1990, DoD reacted to the changing world by altering threat scenarios, developing plans to downsize the forces, and reducing the supply inventories and concluded that a comprehensive, integrated approach was necessary to achieve significant improvements in inventory management. Under the guidance of DoD, wholesale supply activities developed initiatives to improve the computation of asset requirements in order to more accurately identify and dispose of unrequired and inactive inventory. The initiatives contained in the Inventory Reduction Plan, include specific categories of materiel or stockage levels for detailed review by inventory item managers. Each DoD Component developed specific review criteria and methodology tailored to the supply management areas that provided the greatest potential for inventory reduction.

Significant reductions in inventories were achieved as the result of Inventory Reduction Plan initiatives due primarily to the inclusion of contingency and numeric retention items in retention and disposal reviews. Before the Inventory Reduction Plan initiatives, contingency and numeric retention items were generally not reviewed annually.

Several audit reports issued by the Inspector General, DoD; General Accounting Office; and Service audit agencies, have highlighted existing internal control weaknesses and the need for continuing management oversight. Continued reduction in inventory is contingent on reviews becoming part of a continuing long-term inventory reduction program that is integrated into daily inventory management practices. Consistent policies and procedures are an inherent strength of a successful inventory management program. Appendix D discusses each DoD Component's initiatives and shows the results that each reported.

Part II - Finding and Recommendations

Retention and Disposal Procedures

DoD Components did not adequately review and validate for retention or disposal potential reutilization and disposal materiel, contingency and numeric retention stocks, and materiel that did not support active weapons systems and was held for foreign military requisitioners only. In some instances, the reviews that were performed were inadequate. Additionally, recoupment programs were not adequate to preclude the recoupment of unneeded materiel. The conditions occurred because inventory item managers established arbitrary review thresholds, automatically disposed of materiel without review and validation, improperly categorized potential reutilization and disposal materiel as retention stocks, or limited retention and disposal reviews to inactive items. Inventory item managers did not require documentation to support retention decisions as required by DoD directive, and Air Force activities used deferred disposal codes to preclude the review of retention stocks. Inventory item managers did not comply with DoD guidance. Additionally, automated recoupment programs made inappropriate recoupment decisions based on incorrect requirements data; and the recoupment decisions were not validated by the inventory item manager. For the wholesale supply activities we visited, we estimated that $522 million of potential reutilization and disposal materiel, $560 million of contingency retention stock, and $484 million of numeric retention stock was retained when no longer needed, and $6.4 million of unneeded materiel was recouped when there was no known need.

Background

Retention and Disposal Policies. DoD materiel retention and disposal policies were contained in DoD Directive 4100.37, "Retention and Transfer of Materiel Assets," May 24, 1988. The Directive provided that serviceable or economically repairable assets with application to a weapons system in active use by U.S. Forces be retained subject to shelf-life and storage limitation considerations.

DoD Components interpreted this policy as mandating the retention of all weapons systems' related secondary items, as long as the applicable weapons systems or related end item was in use, regardless of the quantity or essentiality of the materiel on hand, or the population or phase-out status of the supported end item. To clarify the policy, the Deputy Secretary of Defense issued a memorandum, "Retention and Disposal of Department of Defense Assets," June 13, 1990, which included the following revisions.

o Items essential to the operation of weapon systems will be retained in reasonable quantities sufficient to support the number of systems in use.

o Inventory quantities will be reduced in proportion to any reduction in the number of systems in use.

o Other items will be retained in minimal quantities sufficient to support the number of systems in use.

The then Assistant Secretary of Defense (Production and Logistics) issued DoD Directive 4140.1, "Materiel Management Policy," January 4, 1993, and DoD Instruction 4140.60, "DoD Materiel Management," January 5, 1993, that updated the policy, responsibilities, and procedures for materiel management. The directive and instruction authorized the publication of a comprehensive policy that consolidated 57 directives into DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," January 25, 1993. The regulation was issued in April 1993 after our audit field work was completed.

The following is a list of significant changes incorporated in the regulation.

o DoD Components may (previously will) retain wholesale items up to the retention limit.

o Wholesale items that are essential to the operation of a weapon system shall be retained in inventory in quantities sufficient to support the number of systems that are in use. Wholesale items not essential to the operation of a weapon system shall be retained in inventory in minimal quantities. Disposition instructions will normally be issued within 1 year of the phaseout of the weapon system.

o Stocks may be held for up to 1 year (2 years when in the interest of national security) after the supported major end item is removed from DoD service.

o DoD Components are required to develop procedures to annually validate the retention criteria for economic retention and contingency retention stocks on an item-by-item basis. (Previously, only contingency retention stocks were subject to periodic validation.)

Potential Reutilization and Disposal Materiel

Wholesale supply activities did not review all line items with potential reutilization and disposal materiel. We attributed this to arbitrary review thresholds, automatic disposals of materiel without review and validation by inventory item managers, improperly categorized potential reutilization and disposal materiel as retention stocks, and reviews primarily limited to inactive items. As a result, although the eight wholesale supply activities we visited disposed of $4.6 billion of unrequired and inactive inventory in FY 1992, unrequired and inactive inventory, valued at the latest acquisition cost, still represented about 30 percent of all assets on hand and on order.

Army Stratification Review Procedures. Army wholesale supply activities did not review all line items with potential reutilization and disposal materiel because arbitrary review thresholds were used. Threshold levels represent the value of potential reutilization and disposal materiel on order and on hand. No studies had been done to show the validity or effectiveness of the arbitrary thresholds. For instance, at the Army Communications and Electronics Command, supply and data systems personnel established review thresholds based on their estimate of how many reviews could reasonably be completed in three months. The Army Communications and Electronics Command established a $50,000 threshold for low dollar line items (less than $25,000 of annual demand) and a $100,000 threshold for high dollar line items (more than $25,000 of annual demand). Based on the September 1992 stratification data file, this threshold criteria resulted in 20,651 line items (97 percent) with a total value of $111 million (60 percent) of potential reutilization and disposal stocks not being reviewed.

In September 1992, the Army Communications and Electronics Command revised its threshold criteria. Both the low dollar and high dollar review thresholds were reduced to $20,000. Again, there were no studies to show the validity or effectiveness of the revised threshold. Based on the $20,000 threshold, 19,153 line items (90 percent) with a total value of $63.4 million (34 percent) would not be reviewed. In contrast, the Army Aviation and Troop Command scheduled for review all potential disposal line items except those with less than $50 of potential reutilization and disposal materiel on hand and on order. Some line items over $50 were not reviewed.

Navy Stratification Review Procedures. Navy wholesale supply activities did not review all items with potential reutilization and disposal materiel because they used arbitrary review thresholds. Additionally, the Navy Aviation Supply Office automatically disposed of potential reutilization and disposal materiel when the value was less than $25,000, without inventory item manager review, unless the line item was specifically excluded by the inventory item manager. No analysis supported the validity of this automatic disposal action. As noted in Part I of the report, automated disposals without supply personnel's prior review have resulted in the concurrent disposal and procurement of the same item. Such conditions could lead to congressional critics again suggesting that DoD was ineffectively managing existing inventory; which, in the past, resulted in a disposal moratorium.

The March 1992 stratification data file contained 61,160 line items with potential reutilization and disposal materiel on hand and on order totaling $2.1 billion. Of the 61,160 line items, 50,075 (82 percent) with materiel totaling $264.7 million (12 percent) had a value less than $25,000 each. Navy Aviation Supply Office supply personnel stated that they had actually disposed of materiel for 17,229 line items with a total value of $59.3 million through the automated disposal program.

Supply personnel at the Navy Ships Parts Control Center did not review line items with less than $20,000 of potential reutilization and disposal materiel on hand and on order. Again, no analysis supported the threshold. Based on the March 1992 stratification data file and the $20,000 threshold,

71,028 (84 percent) line items valued at $236.2 million (17 percent) of the materiel that stratified to potential reutilization and disposal materiel would not have been reviewed.

Air Force Stratification Review Procedures. Air Force wholesale supply activities did not review all items for retention and disposal because potential reutilization and disposal materiel was improperly stratified as retention stock. The San Antonio Air Logistics Center and the Warner Robins Air Logistics Center reviewed all line items with potential reutilization and disposal materiel that were on the quarterly Excess Review Listing. However, some potential reutilization and disposal materiel was improperly retained as contingency and numeric retention stocks because line items had deferred disposal codes; the line items were not included on the Excess Review Listing. The March 1992 stratification contained 106,882 line items with potential reutilization and disposal materiel totaling $1.3 billion and an additional 96,653 line items with deferred disposal assets totaling $6.1 billion.

DLA Review Procedures. Before FY 1993, the Defense Electronics Supply Center and the Defense Industrial Supply Center did not identify and review all line items with potential reutilization and disposal materiel but limited their review to inactive items (no demand in 6 years). For example, personnel at the Defense Industrial Supply Center reviewed less than 25,000 inactive line items during 1992. DLA did not record the number and value of the materiel actually disposed of as a result of the review. The inactive item review criteria were later changed to line items with no demand in 5 years to correspond to the review criteria of the Defense Inactive Item Program.

The September 1992 stratification data file contained 299,769 line items with potential reutilization and disposal materiel totaling $1.5 billion at the two DLA centers we visited. In December 1992, DLA instructed its wholesale supply activities to review all line items with potential reutilization and disposal materiel and the DLA supply centers began performing comprehensive potential reutilization and disposal reviews.

Adequacy of Retention and Disposal Reviews. For the line items we reviewed, the retention and disposal decisions made by the inventory item managers were generally appropriate; however, in some cases, materiel was retained when no reason existed. Inventory item managers did not always review the items or consider the number or obsolescence of supported end items in making retention and disposal decisions, and they often retained additional materiel even when known requirements dictated otherwise. We attributed the inventory item managers' actions, in part, to the conservative organizational culture of wholesale activities that is difficult to change and is attributed to past restrictive disposal policies, especially the 1985 disposal moratorium.

We selected a sample of 265 line items ($313.6 million) with potential reutilization and disposal materiel that inventory item managers recently reviewed from a total of 582,579 line items totaling $6.9 billion. Of the 265 line items, inventory item managers retained $14.9 million of the identified $24.7 million of potential reutilization and disposal materiel for 32 (12 percent) line items without justification. We estimated that inventory

item managers retained $522 million of potential reutilization and disposal materiel without justification. (A comparison of the universe and sample by wholesale supply activity, and the projections are in Appendix B.)

For example, the Army Aviation and Troop Command retained $4.9 million of materiel for three line items that supported obsolete end items. No requirement existed for those items and the inventory item managers indicated that they would have disposed of the materiel if they had reviewed the items.

At the Navy Ships Parts Control Center, we identified three line items with serviceable assets totaling $99,000 and two line items with unserviceable assets totaling $48,000 of potential reutilization and disposal materiel that supported obsolete higher assemblies. No known requirement for the materiel existed. The requirements computation for another item was incorrectly computed and resulted in the retention of $231,000 of materiel that was not required.

At the Air Force's Warner Robins Air Logistics Center, inventory item managers retained $4.8 million of the identified $5.1 million of potential reutilization and disposal materiel for five line items although the materiel was excess to current known requirements. Of the five line items, one included an additional $25,000 of materiel identified as potential reutilization and disposal materiel since the March 1992 stratification. That materiel was also retained and should have been disposed of.

Previous Disposal Actions. Most previous disposal transactions that we reviewed were considered appropriate; however, in a few cases, required materiel was disposed of or additional disposal action should have been taken. We selected a sample of 274 disposal transactions valued at $208 million that were received at Defense Reutilization and Marketing Offices during the second half of FY 1992, to evaluate the propriety of the disposal action. Inventory item managers did not usually have documentation to support the disposal decisions; therefore our conclusions as to the propriety of the disposal actions were based on either current requirements data or reconstructed requirements data. Of the 274 transactions, 272 were appropriate. The two remaining disposal transactions, totaling $64,107, were inappropriate because the line items were managed for less than 2 years and should not have been disposed of under existing procedures; and at the time of audit, the inventory item managers had back orders and materiel on order. Further, for 14 of the 272 line items that were properly disposed of, additional materiel totaling $4.6 million, was retained without a requirement for the materiel.

Most disposal actions were related to systems that had been either completely replaced or superseded by a modification that made the previous version obsolete. For example, the Air Force disposed of components that supported the tail gun assembly of B-52 aircraft and components of the F-100 engines that were replaced during prior modification programs. In some cases the materiel being disposed of had been obsolete for years and was finally being disposed of because of various inventory reduction initiatives and the requirement to reduce the amount of unrequired and inactive inventory.

Contingency and Numeric Retention Stocks

Inventory item managers did not periodically review and validate contingency retention stocks (including numeric retention stocks) to determine whether the materiel was still required in the quantity protected by the retention levels. DoD Components did not require documentation to support retention decisions on an item-by-item basis and Air Force wholesale supply activities used deferred disposal codes to preclude reviews of line items that would otherwise be included in potential reutilization and disposal reviews. Unneeded materiel was retained when there was either no requirement or a reduced requirement for the materiel.

Additionally, the Air Force Materiel Command (AFMC) continued to stratify consumable assets as numeric retention stocks even though that category was deleted as a stratification level as of September 30, 1991. DoD combined numeric retention stock with contingency retention stocks for reporting purposes and the revised procedures, outlined in DoD Regulation 4140.1-R, require that all contingency retention materiel (including former numeric retention stock) be reviewed annually to validate contingency retention or disposal decisions. To ensure a responsible and competent review, the Regulation also requires that contingency decisions be documented on an item-by-item basis to allow for subsequent management review and to provide information for future contingency retention reviews.

Contingency Retention Stock Review Procedures. At the eight wholesale supply activities, we selected a sample of 173 line items with contingency retention stocks totaling $289.8 million from recent stratification reports. Of the 173 line items, inventory item managers retained $42.6 million of the materiel for 37 (21 percent) line items without justification. No documentation existed to support retaining the materiel as contingency retention stock. There were no problems at the two DLA wholesale supply activities. We estimated that $560 million of contingency retention stock at the six Service wholesale supply activities was unneeded and should have been disposed of. Additionally, we estimated that $467 million of contingency retention stock was retained by Navy wholesale supply activities for fill quantities that should either be disposed of or reclassified as economic retention stock.

Army Review Procedures. Before November 1992 no reviews had been made of contingency retention stocks at the Army Communications and Electronics Command and no evidence existed showing that the contingency retention quantities were ever validated for retention. Contingency retention stocks were identified at the Army Aviation and Troop Command each quarter and listings were provided to the inventory item managers for review and validation; however, the inventory item managers' decisions to retain the materiel as contingency retention stock were not documented.

Beginning in December 1992, Army wholesale supply activities took action to review line items with contingency retention stocks. Most line items categorized as contingency retention stocks were eliminated from that requirement level and the affected line items were stratified to other appropriate

supply levels. Subsequently, line items that stratified to potential reutilization and disposal materiel were reviewed by inventory item managers and were either disposed of or were restratified to contingency retention stock.

We reviewed 48 line items with contingency stock totaling $34.1 million at the two Army wholesale supply activities. For 8 of the 48 line items with $5.7 million of contingency retention stock, $5.4 million of the materiel was not justified for retention. Additionally, $6.2 million of noncontingency stock for the same line items was not justified for retention because known requirements did not support the retention of the materiel. Inventory item managers could not tell us why the materiel was being retained. Inventory item managers recently disposed of materiel for 10 line items, totaling $5.3 million, that were improperly classified as contingency retention stock. The items were either obsolete or requirements for the materiel had decreased significantly. The remaining 30 line items, totaling $23.1 million, were properly classified and retained as contingency retention stock.

Navy Review Procedures. Contingency retention stocks were not periodically reviewed at the two Navy wholesale supply activities and the contingency retention stock category improperly included materiel that Navy policy classified as either economic retention stocks or potential reutilization and disposal materiel. As a result, obsolete items were not included in retention and disposal reviews and other economic retention quantities were improperly categorized.

The Naval Supply Systems Command directed that fill quantities (the difference between the computed requirement and the Navy's minimum retention quantity of five) be classified as contingency retention stock. Naval Supply Systems Command policy also authorized the retention of a general force retention increment (based on past demand) as contingency retention stock. Only Navy Aviation Supply Office computed that level. On August 18, 1992, the Naval Supply Systems Command rescinded its policy, and directed that the fill quantity be reclassified as economic retention stock. It also directed that the computation of the general force retention increment be discontinued, effective with the September 1992 stratification process.

We reviewed 22 line items with contingency retention stock totaling $8.7 million at the two Navy wholesale supply activities we visited. For 6 line items, $2.8 million of the $3.3 million of contingency retention stock was improperly categorized as contingency retention stocks -- 2 ($1.9 million) were for general force retention increment quantities, and 4 ($0.9 million of $1 million) were not justified for retention as contingency stock. Additionally, 11 ($3.1 million of $3.5 million) were for fill quantities that restratified to economic retention stock. Prior to our review at the two Navy wholesale supply activities, inventory item managers had reviewed the line items and had either restratified contingency retention materiel to other retention supply levels or, where appropriate, materiel was disposed of. For the remaining five line items with $2.3 million of contingency retention stock, all of the materiel was properly categorized and supported known requirements.

Air Force Review Procedures. No contingency retention stocks were validated for retention or disposal and when file maintenance was required (buy recommendation, missing or erroneous data elements, and potential excess reviews) the contingency retention quantity was generally accepted as valid without further review.

As part of the Inventory Reduction Plan, AFMC directed that deferred disposal codes, which it assigned for repairable items, be removed on September 30, 1992. As a result, the amount of contingency retention stock with deferred disposal codes decreased, at the five air logistics centers, from 96,653 line items ($6.1 billion) on March 31, 1992, to 13,035 line items ($1.6 billion) on December 31, 1992. However, of the 13,035 line items, 6,167 line items ($0.2 billion) still retained AFMC assigned deferred disposal codes and 6,868 line items ($1.4 billion) were coded with deferred disposal codes assigned by inventory item managers that were stratified to contingency retention stock. AFMC had not developed procedures to annually validate the retention of the deferred disposal code or to dispose of the unrequired materiel.

We reviewed 78 line items with contingency stock totaling $240.1 million at the two Air Force activities we visited, and found that 71 line items stratified to contingency retention because of the AFMC assigned deferred disposal code. Potential reutilization and disposal materiel for the other seven line items incorrectly stratified to contingency retention because data were missing from the supply data file and a retention level could not be computed during the stratification process.

For 39 ($181.5 million) of the 78 line items, inventory item managers justified the need to stratify materiel to contingency retention. However, for the remaining 39 line items, materiel for 16 ($24.5 million) was disposed of and 23 ($34.1 million) were improperly justified for retention as contingency retention stocks because the item was either obsolete, being phased out, or supported an end item with declining application and anticipated demands.

Numeric Retention Stock Review Procedures. Air Force logistics centers improperly identified and retained as numeric retention stock, potential reutilization and disposal materiel for consumable items that had a deferred disposal code. Air Force personnel were aware of the improper categorization of the materiel but were unable to make the appropriate systems change because the development of standard DoD supply management, automated information systems precluded changes to current systems. Just as the contingency retention stocks with deferred disposal codes were not reviewed and validated for continued retention, neither were numeric retention stocks.

The Air Force was the only DoD Component that stratified consumable items to numeric retention stocks. Numeric retention stocks included materiel with deferred disposal codes, held for anticipated nonrecoverable assets, uneconomic partial disposals, and other management considerations.

Based on the removal of AFMC-assigned deferred disposal codes from consumable items, the amount of numeric retention stock with deferred disposal codes decreased, at the five air logistics centers, from 56,201 line items

($852 million) on March 31, 1992, to 51,835 line items ($413 million) on December 31, 1992. However, of the 51,835 line items, 728 line items ($18 million) still retained AFMC assigned deferred disposal codes and 51,107 line items ($395 million) were coded with deferred disposal codes assigned by inventory item managers that were stratified to numeric retention stock. AFMC had not developed procedures to annually validate the retention of the deferred disposal code or to dispose of the unrequired materiel.

We selected 27 line items ($25.7 million) with numeric retention stock at the two Air Force activities we visited. The numeric retention quantity for 17 line items ($6.1 million) was not required and the materiel should have been disposed of. The remaining 10 line items ($19.6 million) were justified for retention; however, the materiel should have been properly classified as either economic retention or contingency retention stocks. We estimated that $484 million of numeric retention stock was unneeded and should have been disposed of.

Materiel Held for Foreign Military Sales

DoD Components retained materiel held for foreign military sales requisitioners only (acquisition advice code P) when no requirement for the line items existed. The Services' wholesale supply activities either did not offer the materiel to foreign military customers for buyout or the materiel was offered for buyout and subsequently rejected. Wholesale supply activities could not explain why the unrequired materiel was retained longer than the 1 to 2 years authorized by DoD regulations.

DoD Regulation 4140.1-R requires that disposition instructions will normally be issued within 1 year of the phaseout of the weapons system when requirements for active U.S. Armed Forces or cooperative logistics support agreements with foreign military customers cease. Materiel may be held for up to 1 year after the end item is removed from service, with a written determination from the commander of the wholesale supply activity that the retention of the materiel is in the best interest of the DoD. Materiel may be held for up to 2 years if the head of the managing agency determines that the retention of the materiel is in the interest of national security.

We selected a sample of 64 line items, with stock totaling $12.8 million, that were identified in the supply files of six of the eight wholesale supply activities as materiel held for foreign military sales requisitioners only. Of the 64 line items, the materiel for 22 line items ($4.2 million) was initially retained as acquisition advice code P because the wholesale supply activity was awaiting a possible foreign military sales buyout. During our review, inventory item managers disposed of materiel for the 22 line items because the buyout offers to foreign military sales customers were rejected. Materiel for 5 line items ($0.6 million) either had valid requirements or was owned by a foreign military customer and under repair at a Defense repair facility.

For the remaining 37 line items, totaling $8 million, the materiel was either no longer required or improperly catalogued. Of the 37 line items, 4 ($0.9 million) were improperly catalogued, 18 ($2.9 million) were retained when there was little or no justification for retention, and 15 ($4.2 million) were offered formally and informally to foreign military customers for buyout. Although the foreign military customers rejected the offers, the materiel was retained. We could not determine how long the materiel, including unserviceable assets, was held after active requirements declined. In over 4 years, no demand existed for several items, and when they were offered for sale to foreign customers those customers had no interest in the items. Additionally, there was no written documentation to justify retention of the materiel.

Recoupment Transactions

Wholesale supply activities were inappropriately recouping materiel from the DRMS that was previously sent there for disposal and was not needed for current or anticipated requirements. Unneeded materiel was usually recouped under an automated recoupment program, without review and validation by the inventory item manager, and in some cases, the wholesale supply activity that recouped the materiel, originally disposed of it.

We reviewed a sample of 103 recoupment transactions totaling $2.9 million from a universe of 2,594 recoupment transactions totaling $33.1 million processed during the second half of FY 1992 for the eight activities in our review. The recouped materiel for 48 ($909,961) of the 103 transactions supported known requirements; and in most cases, an activity other than the wholesale supply activity disposed of the materiel. The inventory item manager recouped a larger quantity than was required to support existing deficiencies for two recoupment transactions; only $28,853 of the $174,476 in recouped materiel was required. For 41 recoupment transactions, totaling $468,792, all the recouped materiel was not required and in some cases was redisposed. We were unable to make a determination for the remaining 12 recoupment transactions because documentation was no longer available for review. We estimated that at least $6.4 million of materiel was not required and should not have been recouped.

Of the 41 recoupment transactions that were not required, 35 ($180,530) resulted from automated recoupment programs that did not require prior approval from the inventory item manager and that did not consider whether the materiel was originally disposed of by the recouping activity or whether the materiel was required to support known requirements. The six remaining recoupments, totaling $288,264, were manually recouped. Current inventory item managers were not responsible for the recoupment and little or no documentation was available to determine why the materiel was recouped.

The DoD Components differed in their review of excess materiel as reported by the DRMS. Those that included inventory item manager review prior to recoupment made better recoupment decisions.

Army Recoupment Review Procedures. The Army wholesale supply system screened available excess materiel reported by the DRMS and issued automated recoupment transactions for the excess materiel when there was a computed requirement for the materiel. When there was no computed requirement for the materiel, inventory item managers reviewed the excess materiel referrals and made the final recoupment decision. Of the 39 recoupment transactions we reviewed, 19 were valid, 12 could not be reviewed because documentation was no longer available for review, and 8 were invalid because either no requirement for the materiel existed or the recouped materiel was unusable. The eight invalid recoupment transactions, totaling $105,990, were recouped under automated recoupment procedures.

Navy Recoupment Review Procedures. Navy activities automatically recouped materiel from the DRMS when its computer system determined that the materiel was required. During our audit, Navy wholesale supply activities initiated action to restrict the items that the DRMS reported to it. Only those items that were turned in by activities other than the wholesale supply activity would be reported for potential recoupment. This practice was initially limited to consumable items but was later expanded to include repairable items. Of the 24 recoupment transactions we reviewed, only 8 were valid. The remaining 16 recoupment transactions, totaling $54,720, were invalid and were recouped under automated recoupment procedures.

Air Force Recoupment Review Procedures. The Air Force wholesale supply system screened available excess materiel reported by the DRMS before referring the recoupment transaction to the inventory item managers. Inventory item managers reviewed recoupment recommendations and issued a manual recoupment transaction for needed items. Of the 20 recoupment transactions we reviewed, 12 were valid. Additionally, two recoupment transactions were partially valid because a portion of the recouped materiel was required to support requirements; only $28,853 of the $174,476 in recouped materiel was required. The remaining six recoupment transactions, totaling $288,263, were invalid and inventory item managers could not explain why the materiel was recouped.

DLA Recoupment Review Procedures. DLA wholesale supply activities automatically recouped materiel reported by the DRMS when the line item value was less than $1,000; however, inventory item managers reviewed all potential recoupment transactions when the line item value was more than $1,000. During our review, the Defense Industrial Supply Center initiated actions to preclude the recoupment of its own disposals by screening out materiel that it had previously disposed of. Defense Electronics Supply Center personnel stated that inventory item managers will continue to review disposal actions for possible recoupment regardless of who disposed of the materiel. Of the 20 recoupment transactions we reviewed, 9 were valid. Inventory item

managers could not explain why the other 11 recoupment transactions, totaling $19,820, were made because there was no need for the materiel and the materiel was either obsolete or unserviceable.

Based on our sample of recoupment transactions, we believe that an automated decision to recoup materiel, without review by inventory item managers, was not generally appropriate. The ultimate decision was most appropriate when the inventory item manager reviewed the item and recouped the materiel based on more complete knowledge of the item.

Conclusion

Items with potential reutilization and disposal materiel were not always reviewed, materiel was being disposed of without an inventory item manager review, and materiel was retained without a justification. Other materiel was retained because deferred disposal codes were assigned to line items and the codes were not periodically validated. Additionally, materiel held for foreign military sales was retained without an active DoD requirement or foreign interest in the item. The conditions existed because of an organizational culture that, in some cases, viewed the disposal of excess materiel as inappropriate and unwarranted even with little or no requirement for the materiel. Further, adequate controls were not established to ensure that required procedures were followed.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Commander, Army Materiel Command; Commander, Naval Supply Systems Command; Commander, Air Force Materiel Command; and Director, Defense Logistics Agency:

a. Consistently and routinely review all items with potential reutilization and disposal materiel, promptly reclassify materiel that is retained, and dispose of materiel that is obsolete and unneeded and

b. Periodically review all contingency retention stock, and validate and document the reason for the retention and the quantity retained in accordance with DoD policy.

Army Comments. The Army concurred with the recommendation and stated that it has actively pursued the reduction of unrequired inventory as part of the Inventory Reduction Plan during the last 2 years. Additionally, future guidance will contain stringent enough parameters to ensure that potential reutilization and disposal materiel is thoroughly reviewed for retention or disposal; however,

the estimated date for issuance of the guidance was not provided. Contingency retention levels must be reviewed and justified on an annual basis. The Army's comments did not indicate concurrence or nonconcurrence concerning the internal control weakness. See Part IV of the report for the complete text of the Army's comments.

Navy Comments. Comments were not received from the Assistant Secretary of the Navy (Financial Management).

Air Force Comments. The Air Force concurred with the recommendation and stated that it has actively pursued the reduction of unrequired inventory during the last 2 years, has removed weapon systems codes (deferred disposal codes), and is closely monitoring the number and dollar value of items with deferred disposal codes. The Air Force comments did not indicate concurrence or nonconcurrence concerning the internal control weakness. See Part IV of the report for the complete text of the Air Force's comments.

DLA Comments. DLA partially concurred with the recommendation and stated that effective December 1992 it instituted an aggressive disposal program which requires review of all items as delineated in Recommendation 1.a. Annual on-site reviews are conducted to ensure appropriate oversight. DLA also stated that it verbally directed, during FY 1993, the supply centers to review contingency retention stocks on an annual basis, and that written justification for such levels would be required by item. Formal policy guidance would be issued in FY 1994. However, DLA did not concur concerning the internal control weakness identified in the report. See Part IV of the report for the complete text of the DLA's comments.

Audit Response. The management comments satisfy the intent of the recommendation; however, the Army did not provide an estimated completion date for the issuance of future guidance and the Army, the Air Force, and DLA did not respond to that part of our recommendation to "promptly reclassify materiel that was retained." When a decision to retain potential reutilization and disposal materiel is made, inventory item managers are required to reclassify the materiel as either required inventory or as retention stocks to preclude, at least partially, the reidentification of the materiel as potential reutilization and disposal materiel during the next review cycle. Additionally, the Army and Air Force did not address the internal control weakness identified in the report. Also, DLA did not provide the rationale for the nonconcurrence to the internal control weaknesses identified in the report.

The Air Force response included a statement that "readers outside the Department may inappropriately conclude that the Department is not aggressively taking steps to reduce inactive inventory." We recognized in the report that significant steps have been taken by DoD Components during the last few years as part of the Inventory Reduction Plan. Part I and Appendix D of the report highlights the actions taken by management to reduce unneeded and inactive inventory.

We request that the Army, the Air Force, and DLA provide additional comments and that the Navy respond to the final report.

2. We recommend that the Commander, Navy Aviation Supply Office review all items with potential reutilization and disposal materiel before disposal, including items with materiel totaling less than $25,000.

Navy Comments. Comments were not received from the Assistant Secretary of the Navy (Financial Management).

Audit Response. We request that the Navy respond to the final report.

3. We recommend that the Commander, Air Force Materiel Command:

a. Reclassify all numeric retention stocks for consumable items to appropriate stratification supply levels and

b. Pending reclassification, periodically review all numeric retention stock, and validate and document the reason for the retention and the quantity retained in accordance with DoD policy.

Air Force Comments. The Air Force concurred with the recommendation and stated that because of limitations of current information systems the numeric retention stock for consumable items will not be reclassified until the DoD Materiel Management Standard System is implemented in October 1995. Pending implementation, numeric retention stocks are being reviewed in the same manner as contingency retention stocks. The Air Force also stated that while our analysis and findings are based on March 1992 data we refer to the guidance in DoD Regulation 4140.1-R, distributed in April 1993, that eliminated contingency retention stock as a valid retention category.

Audit Response. The Air Force currently has the capability to restratify numeric retention stock levels to either active (approved acquisition objective) or inactive (economic or contingency retention) inventory levels without waiting for the implementation of the DoD Materiel Management Standard System. Additionally, while the policy to restratify numeric retention stocks to other supply levels was formally implemented in DoD Regulation 4140.1-R, the then Office of the Assistant Secretary of Defense (Production and Logistics) directed the elimination of numeric retention stocks as of September 30, 1991. All DoD Components, except the Air Force, restratified numeric retention stocks to other appropriate stock levels.

We request that the Air Force provide further comments providing specific reasons for not implementing the recommendation under the current materiel management system and provide concurrence or nonconcurrence to the internal control weakness.

4. We recommend that the Commander, Army Materiel Command; Commander, Naval Supply Systems Command; and Commander, Air Force Materiel Command promptly identify excess materiel held specifically for foreign military customers, offer the materiel to foreign military customers (at standard or discounted prices) when no requirement for active weapons systems exist, and finalize all buyouts within the established 1- or 2-year time frame.

Army Comments. The Army concurred with the recommendation and is working on an initiative to ensure that excess materiel is offered to foreign military customers within the established time frames and is reinstating purpose code "N" to identify materiel held specifically for sale to foreign military customers. Implementation is scheduled for completion by September 30, 1994.

Navy Comments. Comments were not received from the Assistant Secretary of the Navy (Financial Management).

Air Force Comments. The Air Force concurred with the recommendation and stated that excess materiel held specifically for foreign military customers is promptly being identified as a result of policy implemented in May 1993. The buyouts will be finalized within the established one or two year timeframe.

Audit Response. The actions being taken by the Army, if fully implemented, will satisfy the intent of the recommendation. The reported actions taken by the Air Force are responsive but were implemented after the completion of our audit work and were not evaluated. We request that the Air Force provide a copy of the May 1993 policy, that the Army and Air Force provide concurrence or nonconcurrence with internal control weakness, and that the Navy respond to the final report.

5. We recommend that the Commander, Army Materiel Command; Commander, Naval Supply Systems Command; and Director, Defense Logistics Agency require the review of all automated recoupment decisions before initiating the actual recoupment process, or develop an automated screening process that precludes the recoupment of unneeded materiel to ensure that the automated decision is appropriate.

Army Comments. The Army concurred with the recommendation and stated that major subordinate commands will be advised that recoupment transactions require thorough review and approval prior to the initiation of a recoupment transaction; however, the estimated date of completion was not provided.

Navy Comments. Comments were not received from the Assistant Secretary of the Navy (Financial Management).

DLA Comments. DLA partially concurred with the recommendation and will review their current computer logic to preclude the problems identified in the report. Action is estimated for completion by September 30, 1994. However, DLA did not concur with the internal control weaknesses identified in the report.

Audit Response. The planned actions being taken by the Army and DLA will satisfy the intent of the recommendation. However, DLA did not provide the rationale for the nonconcurrence to the internal control weaknesses identified in the report. We request that DLA provide additional comments, that the Army provide concurrence or nonconcurrence with the internal controls and an estimated date of completion, and we request that the Navy respond to the final report.

Part III - Additional Information

Appendix A. Glossary

Approved acquisition objective. The approved acquisition objective is the quantity of an item authorized for peacetime and wartime requirements to equip and sustain U.S. Armed Forces and Allied Forces in accordance with current DoD policies and plans. The quantity shall be sufficient to support other U.S. Government agencies, as appropriate.

Contingency retention stock. Contingency retention stock is the quantity of an item that is greater than the approved acquisition objective and economic retention stock for which there is no predictable demand or quantifiable requirement. Normally it would be allocated as potential reutilization stock, unless otherwise determined to be retained for specific contingencies. Those categories include military contingencies; foreign military demand; or other general contingencies, such as potential usefulness, extreme procurement problems, and nonmilitary contingencies.

Economic retention stock. Economic retention stock is the portion of the quantity of an item that is greater than the approved acquisition objective, determined to be more economical to retain for future peacetime issues than to dispose of it and satisfy projected future requirements through new procurement and repair. To warrant economic retention, an item must have a reasonably predictable demand rate.

Inactive inventory. Inactive inventory (formerly inapplicable assets) is the quantity of materiel above the approved acquisition objective that is not required to meet peacetime and wartime requirements. This includes materiel that is expected to be used in the future, less costly to hold than to dispose of and reprocure in the future (economic and contingency retention stocks, including the former numeric retention stock), and identified as potential reutilization and disposal materiel.

Numeric retention stock. Formerly, numeric retention stock was the quantity of an item greater than all identified requirement objectives but for which disposal was infeasible or uneconomical or for which a management decision had been made to retain stock in the supply system. This category of stock is no longer valid.

Potential reutilization and disposal materiel. Potential reutilization and disposal materiel is component materiel identified by the item manager for possible disposal but with potential for reutilization. The materiel has the potential of being sent by an inventory item manager to the DRMS for possible reutilization by another Component; by a Federal, state, or local governmental agency; or for sale to the public.

Appendix B. Audit Site Selection, Audit Sample Methodology, and Projections

Audit Site Selection. We judgmentally selected eight wholesale supply activities -- two each from the Army, Navy, Air Force, and DLA -- based on the number and value of national stock numbers with potential reutilization, contingency retention, and numeric retention stocks. We also considered the types of items managed by the wholesale supply activities and the proportion of items with unrequired and inactive inventory.

Audit Sample Methodology. We performed separate audit tests of current inventory item managers' decisions regarding the retention and disposal of secondary items, recent disposal transactions, and restricted requisition items. Additionally, we reviewed recent recoupment transactions processed by the DRMS. The following tests were included in our review.

Retention and Disposal Reviews. We selected a stratified random sample of line items with potential reutilization, contingency retention, and numeric retention stocks identified on recent stratification data files -- March 1992 for the Air Force and Navy, June and September 1992 for the Army, and September 1992 for DLA. We reviewed the inventory item managers' decision to retain or dispose of the potential reutilization materiel and the justification to retain or dispose of contingency retention stocks (including numeric retention stocks). The universe of line items and the actual sample size taken are shown in Tables B.1., B.2., and B.3. (The footnote is at the end of Table B.6.)

Table B.1. Universe and Sample Size of Items Reviewed Potential Reutilization and Disposal Materiel
(Value in Millions)

	Universe		Sample Size	
Activity*	Items	Value	Items	Value
ATCOM	9,292	$ 357.9	35	$111.9
CECOM	21,358	185.4	17	10.0
ASO	61,160	2,134.9	40	58.0
SPCC	84,118	1,424.3	37	32.2
SAALC	66,901	578.5	14	35.5
WRALC	39,981	770.8	33	44.7
DESC	210,813	1,165.6	39	7.2
DISC	88,956	285.3	50	14.2
Total	582,579	$6,902.7	265	$313.6

Table B.2. Universe and Sample Size of Items Reviewed
Contingency Retention Stock
(Value in Millions)

	Universe		Sample Size	
Activity*	Items	Value	Items	Value
ATCOM	3,552	$ 116.8	15	$ 11.0
CECOM	6,088	261.6	33	23.1
ASO	21,964	520.0	10	5.9
SPCC	26,613	399.3	12	2.8
SAALC	7,722	922.6	28	133.7
WRALC	5,996	1,203.9	50	106.4
DESC	22,993	271.5	11	6.0
DISC	361	4.9	14	0.9
Total	95,289	$3,700.6	173	$289.8

Table B.3. Universe and Sample Size of Items Reviewed
Numeric Retention Stock
(Value in Millions)

	Universe		Sample Size	
Activity*	Items	Value	Items	Value
SAALC	36,497	$572.3	10	$22.2
WRALC	20,916	192.9	17	3.5
Total	57,413	$765.2	27	$25.7

Previous Disposal Transactions. Additionally, we selected a stratified random sample of disposal transactions that were processed by the DRMS during the first half of FY 1992. The universe of line items and the actual sample size taken are in Table B.4. (The footnote is at the end of Table B.6.)

Table B.4. Universe and Sample Size of Items Reviewed
Previous Disposal Transactions
(Value in Millions)

	Universe		Sample Size	
Activity*	Items	Value	Items	Value
ATCOM	4,773	$ 111.8	29	$ 2.3
CECOM	4,411	215.1	42	30.4
ASO	16,270	700.7	30	24.1
SPCC	23,097	308.5	28	33.0
SAALC	3,882	194.4	48	94.4
WRALC	5,482	162.7	36	17.9
DESC	14,131	57.3	30	1.2
DISC	5,602	33.8	31	4.7
Total	77,648	$1,784.3	274	$208.0

Restricted Requisition Items. We also selected a sample of line items that were coded with restricted requisition acquisition advice codes P (see Table B.5.). Acquisition advice code P designates items that are not authorized

for general issue but are stocked for foreign military sales only. This materiel is held for specific reasons and should not be issued without approval of the inventory item manager. (The footnote is at the end of Table B.6.)

Table B.5. Universe and Sample Size of Items Reviewed
Restricted Requisition Items - Acquisition Advice Code P
(Value in Millions)

	Universe		Sample Size	
Activity*	Items	Value	Items	Value
ATCOM	3	$ 0.1	1	$ 0.1
CECOM	10	0.2	7	0.2
ASO	5	0.3	5	0.3
SPCC	3,068	28.8	11	2.9
SAALC	3,412	34.3	20	4.8
WRALC	1,130	30.5	20	4.5
Total	7,628	$94.2	64	$12.8

Recoupment Transactions. Additionally, we selected a random sample of recoupment transactions that were processed by the DRMS during the first half of FY 1992. The universe of items and the actual sample size taken are in Table B.6.

Table B.6. Universe and Sample Size of Items Reviewed
Recoupment Transactions
(Value in Millions)

	Universe		Sample Size	
Activity*	Items	Value	Items	Value
ATCOM	17	$ 1.4	17	$1.4
CECOM	136	5.6	22	0.7
ASO	461	7.2	10	0.1
SPCC	286	2.6	14	0.1
SAALC	107	13.6	11	0.4
WRALC	80	1.5	9	0.2
DESC	1,119	0.7	10	0.0
DISC	388	0.5	10	0.0
Total	2,594	$33.1	103	$2.9

*Activities

ATCOM	Aviation and Troop Command
CECOM	Communications and Electronics Command
ASO	Aviation Supply Office
SPCC	Ships Parts Control Center
SAALC	San Antonio Air Logistics Center
WRALC	Warner Robins Air Logistics Center
DESC	Defense Electronics Supply Center
DISC	Defense Industrial Supply Center

Audit Sample Projections. We made four projections based on our review of line items with potential reutilization and disposal materiel, contingency retention stock, numeric retention stocks, and recoupment transactions.

Potential Reutilization and Disposal Materiel. We reviewed 265 line items ($313.6 million) with potential reutilization and disposal materiel. Inventory item managers retained $14.9 million of the materiel for 32 line items without justification. Our sample of 265 line items was selected from a universe of 582,579 line items with potential reutilization and disposal materiel totaling $6.9 billion. Based on our sample and using a 90-percent confidence level, we projected that inventory item managers retained unneeded materiel, totaling $522 million, plus or minus $182 million, without justification.

Contingency Retention Stocks. We reviewed 173 line items ($289.8 million) with contingency retention stocks from a universe of 95,289 line items totaling $3.7 billion. Inventory item managers retained 37 line items ($42.6 million) with contingency retention stocks without justification. Based on our sample and using a 90-percent confidence level, we projected that inventory item managers retained unneeded contingency retention stocks, totaling $560 million, plus or minus $186 million, without justification. Additionally, we estimated that $467 million of Navy contingency retention stock, plus or minus $205 million, was retained for fill quantities that should be either disposed of or reclassified as economic retention stock.

Numeric Retention Stocks. We reviewed 27 line items ($25.6 million) with numeric retention stocks from a universe of 57,413 line items totaling $765 million. Inventory item managers retained 17 line items ($6.1 million) with numeric retention stocks without justification. Based on our sample and using a 90-percent confidence level, we projected that inventory item managers retained unneeded numeric retention stocks, totaling $484 million, plus or minus $149 million, without justification.

Recoupment Transactions. Wholesale supply activities recouped a significant amount of materiel from the DRMS when there was no requirement for the materiel. Of the 103 line items in our sample, 43 line items should not have been either partially or totally recouped. Based on our random sample with 90 percent confidence, we projected that $6.4 million of materiel, plus or minus $2.6 million, was not required and should not have been recouped.

Appendix C. Prior Audits and Other Reviews

Inspector General, DoD

Inspector General, DoD, Report No. 90-082, "Report on the Survey of Materiel Retention Policy and DoD Storage Capacity," June 8, 1990, reported that the AFMC, formerly the Air Force Logistics Command, had adopted several initiatives to reduce the impact of inventory growth and storage capacity problems. Special teams were established to review storage space constraints and identify actions needed to relieve overcrowding. Monthly warehouse surveillance reviews were established resulting in significant disposal actions. AFMC had directed the removal of deferred disposal codes from items that support weapons systems that have been in the supply system for specified periods because deferred disposal codes preclude the review of items for potential disposal. Additionally, special analyses had been done to identify items held only to support foreign military sales systems and to justify retention decisions for this materiel. The report made no recommendations.

General Accounting Office

o General Accounting Office Report No. NSIAD 90-68 (OSD Case No. 8219), "Army Inventory: Growth in Inventories That Exceed Requirements," March 22, 1990, stated that inapplicable inventory increased because materiel was retained to support end items that were being phased out of the Army's system, demand forecasted for items often did not materialize, and the data file that computed requirements contained erroneous information. The General Accounting Office determined that more timely and aggressive actions by inventory item managers could have reduced the procurement of unrequired items. The General Accounting Office recommended that the Army Materiel Command dispose of obsolete and unrequired materiel, update requirements computations more responsively, and improve the accuracy of the requirements data file. Management agreed with the findings and recommendations and stated that corrective actions were already underway to rectify many of the deficiencies addressed in the report.

o General Accounting Office Report No. NSIAD 90-100 (OSD Case No. 8114), "Defense Inventory: Growth in Air Force and Navy Unrequired Aircraft Parts," March 6, 1990, addressed the growth in secondary item inventories of aircraft parts, especially growth in unrequired inventory not related to increased military capability. The General Accounting Office found that the major reasons for the growth in unneeded stocks were the reduction of demand due to system modifications, phase out of aircraft, overestimation of usage rates, reduction of war reserves and safety levels, improvement in reliability, and reclassification of consumable items as repairable. The General Accounting Office recommended that DoD ensure more accurate reporting of

required and unrequired items and to provide better visibility of unrequired items. Management officials agreed with the thrust of the findings and conclusions and stated that major programs were underway to reduce unnecessary inventory growth.

o General Accounting Office Report No. NSIAD 90-111 (OSD Case No. 8216), "Defense Inventory: Growth in Ship and Submarine Parts," March 6, 1990, reported that the major reasons for the Navy's unrequired inventory of ship and submarine parts were requirements that did not materialize, the deactivation of older ships, and the replacement and phasing out of equipment. The General Accounting Office recommended that the Navy identify phased out and obsolete weapons systems to item inventory managers, ensure that supply records identify those items, and purchase the items only when an immediate need existed for them. The then Assistant Secretary of Defense (Production and Logistics) agreed with the findings and recommendations and stated that aggressive programs were underway to reduce unnecessary inventory growth.

o General Accounting Office Report No. NSIAD 90-236 (OSD Case No. 8393), "Army Inventory: Army Annually Spends Millions to Keep Retention-Level Stocks," September 11, 1990, reported that the Army's retention policy and practices resulted in keeping virtually all inventory applicable to active weapons systems regardless of its quantity, condition, or number of end items supported. For many line items, retention inventory exceeded that needed to support weapons systems until they are phased out of the Army. Additionally, inventory item managers were generally unaware of the requirement to document their reasons for retaining contingency and numeric retention stocks and did not have time to manage retention stocks. The General Accounting Office recommended that the Army Materiel Command develop specific retention and disposal guidance in accordance with revised inventory policy, ensure that computer systems changes are documented, and properly classify unrequired materiel as potential reutilization and disposal materiel unless there is documented justification for classifying the materiel as retention stocks. The then Assistant Secretary of Defense (Production and Logistics) agreed with the findings and recommendations and provided information on how and when the recommendations would be implemented and stated that inventory item managers would have to manually move stock into retention stock levels with appropriate justification.

o General Accounting Office Report No. NSIAD 93-29 (OSD Case No. 9188), "Defense Logistics Agency: Why Retention of Unneeded Supplies Persists," November 4, 1992, reviewed DLA's inventory of inactive items to determine the extent of the inactive items and to determine why items with no demand were retained. The General Accounting Office found that DLA had 497,572 line items with $980 million of assets that had not been requisitioned for at least 3 years. Although DLA established programs to reduce the number of line items managed and to dispose of unneeded assets, not all items were covered by those programs and problems existed within the programs. The General Accounting Office made no formal recommendations; however the then Deputy Assistant Secretary of Defense (Logistics) instructed DLA to take corrective actions on identified problem areas.

Army Audit Agency

Army Audit Agency Report No. NE-91-202, "Dormant Wholesale Stock," April 23, 1991, evaluated the adequacy of policies and procedures for monitoring dormant stocks, identifying and disposing of unneeded stocks (including the Defense Inactive Item Program), and preventing the return of unneeded materiel to the wholesale supply system. The report stated that the Army had initiated several actions to reduce the amount of unneeded materiel but that there were additional procedural and systemic weaknesses in the way that unneeded stock was identified and disposed. The Army Audit Agency recommended that changes be made to the Commodity Command Standard System to eliminate identified problems and to ensure that the supply system identified materiel held for special purposes, particularly materiel held for foreign military customers. Management agreed with the finding and recommendations and either initiated corrective actions during the audit or agreed to implement the recommendations.

Air Force Audit Agency

Air Force Agency Audit Report No. 8126124, "Inventory Controls - Stock Retention Management of Recoverable Assets," June 15, 1989, evaluated the adequacy of inventory controls over excess centrally procured investment items stored at four of the five air logistics centers. The audit found that procedures did not always identify obsolete stocks for disposal; assets were unnecessarily retained because deferred disposal codes were assigned; and in some instances, customer countries did not require items held for foreign military sales. The Air Force Audit Agency recommended that Air Force retention and disposal policy be updated to reflect current DoD disposal policy, and that the Air Force remove deferred disposal codes to permit review of items on the excess review list, develop a weapons systems phaseout policy and procedures, and direct the air logistics centers to dispose of materiel held for foreign military customers that was either unserviceable or that had not been purchased during a buyout offer. Management agreed with the audit results and recommendations and planned to update existing policy, conduct special reviews of items with deferred disposal codes, and review retention criteria for foreign military peculiar items.

Appendix D. Inventory Reduction Plan

In May 1990, DoD issued the DoD Inventory Reduction Plan which identified estimated savings of $18 billion over the next 7 years. During FY 1990, inventories were reduced by $4.3 billion. In FY 1991, during Operation Desert Shield and Operation Desert Storm, inventories were further reduced by $9.4 billion.

The Deputy Under Secretary of Defense for Logistics (formerly the Deputy Assistant Secretary of Defense [Logistics]) and the Defense Materiel Management Board are responsible for the execution of the Inventory Reduction Plan that includes the elimination of inactive items from the supply inventory and the disposal of nonessential or inactive materiel.

The heart of the Inventory Reduction Plan, as shown in the Table D., is a 10-point program with concise guidance and specific milestones for DoD Components.

Table D. 10-Point Program

- Improve in-transit and in-store asset visibility.
- Terminate unneeded purchase requests and contracts.
- Reduce replenishment objectives.
- Accelerate the weapon system management concept.
- Eliminate inactive items from the inventory.
- Dispose of nonessential or inactive materiel.
- Reduce intermediate and consumer level stocks.
- Substitute direct vendor delivery for inventory investment.
- Implement a standard materiel management system.
- Establish an inventory reduction program to achieve long-term reductions.

The Services and DLA developed separate implementation programs for the DoD Inventory Reduction Plan that include a wide variety of inventory management initiatives designed to reduce secondary item inventories. Routine retention and disposal reviews are discussed in Part II of the report but a description of the inventory reduction programs and the results of the programs follow. We did not verify the accuracy of the reported results.

Army Programs. The two Army wholesale supply activities implemented separate inventory reduction initiatives. The programs were limited in scope but generated additional inventory reductions that otherwise may not have been identified during routine retention and disposal reviews. Materiel was considered dormant at a particular storage location for which there had been no activity for 2 or more years.

Dormant Asset Review. The Army Communications and Electronics Command identified and disposed of dormant materiel that was stocked at the Sacramento and Tobyhanna depots. As of January 1993, this program disposed of about $61 million (10,580 lines) of dormant stocks - $18 million (5,314 lines) for Sacramento and $43 million (5,266 lines) for Tobyhanna. This

program was initiated at the Tobyhanna depot but was subsequently delayed so that the program at the Sacramento depot, scheduled for closure, could be completed. The program is expected to be performed at other depots.

Dormant Stock Program. The Army Aviation and Troop Command identified and disposed of dormant consumable, repairable and major end items. About $257.2 million (14,447 lines) of dormant materiel was disposed of during the 12 months ending in October 1992.

Navy Programs. The Navy wholesale supply activities participated in a Navy program to offer for sale materiel with foreign military application to foreign customers before disposing of the materiel. Materiel was offered at discounted prices to encourage sale and to prevent disposal. Naval Supply Systems Command personnel stated that the program is ongoing and several offers were made to foreign customers. The Navy has sold approximately $2 million of materiel under this program.

At the Navy Ships Parts Control Center, foreign military customers were offered 27,030 line items with $588.5 million of materiel valued at standard price. They received 380 requisitions for materiel valued at $1.1 million. The materiel was sold at a discounted price of $491,100.

Additionally, the two Navy wholesale supply activities implemented separate inventory reduction initiatives. We could not determine the number and value of disposals that were made as a result of those initiatives because the wholesale supply activities did not maintain separate statistics by program.

Program Data Expansion. When a system was identified as obsolete, the ASO identified unique assemblies, subassemblies, and components used on the system. Inventory item managers reviewed items to determine whether to retain the item or remove the item from the supply system and dispose of all assets.

Ship Decommissioning. The Navy Ships Parts Control Center identified unique items for ships that were being decommissioned. When no other use was identified for the items, action was taken to dispose of the materiel and remove the line item from the supply system.

Air Force Programs. AFMC implemented an inventory reduction initiative -- CORAL Reduce -- in FY 1992 to reduce the number and value of unrequired and inactive principal and secondary item inventory without disposing of needed assets. During FY 1992, the air logistics centers reviewed line items with large dollar value of long supply inventory in a number of categories, including line items not currently under review and line items that did not have an AFMC-assigned deferred disposal code. The review programs are continuing in FY 1993 and the results from FY 1992 are discussed below.

Inventory Item Manager Assigned Deferred Disposal Codes. Inventory item managers at the San Antonio Air Logistics Center and the Warner Robins Air Logistics Center reviewed 414 line items with contingency or numeric retention stock totaling $41.4 million to which the inventory item

managers assigned a deferred disposal code. The inventory item managers removed the deferred disposal code from 153 line items, and retained the deferred disposal code for 260 line items. At the time of audit, the remaining line item was still pending review. As a result, $7.8 million of materiel relating to 200 of the 414 line items that inventory item managers reviewed was sent to disposal.

Nondemand and No Demand Items. Inventory item managers at the San Antonio Air Logistics Center and the Warner Robins Air Logistics Center reviewed nondemand and no demand items to ensure that only minimum not maximum quantities were retained. Repairable items with missing or conflicting data do not generate a requirement, and those assets are categorized as potential reutilization and disposal materiel. When file maintenance is completed the assets invariably restratify to supply levels below the retention level. Inventory item managers also reviewed insurance items and items with no demand. Inventory item managers disposed of assets for 640 line items ($9.5 million) of the 971 insurance line items ($32 million) and 935 line items ($70 million) of the 1,183 line items with no demand ($120.7 million).

Air Force Materiel Command Assigned Deferred Disposal Codes. On September 30, 1992, the air logistics centers removed most AFMC-assigned deferred disposal codes. Inventory item managers reviewed each item and either assigned an inventory item manager-assigned deferred disposal code or disposed of any unneeded materiel. The codes identified items that supported active weapons systems within the Air Force and represented potential reutilization and disposal stocks that were restratified to contingency retention stock for repairable items and numeric retention stocks for consumable items.

Preliminary results for the first quarter of FY 1993 showed, overall, that the total number of line items with a deferred disposal code decreased from 152,854 ($6.9 billion) in March 1992 to 58,178 ($1.9 billion) in December 1992. Line items with AFMC-assigned deferred disposal codes decreased from 141,927 ($6.5 billion) in March 1992 to 7,026 ($0.2 billion) in December 1992. However, the number and value of line items with inventory item managers assigned deferred disposal codes significantly increased from 10,927 ($0.4 billion) to 51,152 ($1.7 billion) during this period. The results of the review are included in Part II of the report.

DLA Programs. DLA supply centers generally reviewed inactive items to determine whether to retain or dispose of materiel. DLA's inactive item review program is discussed in Part II of the report. Beginning in FY 1993, the supply centers began reviewing items with potential reutilization and disposal materiel. Additionally, contingency retention stocks, primarily diminishing manufacturing items that are no longer manufactured or too expensive to reprocure, are scheduled for review to determine whether to retain or dispose of the materiel.

Potential Reutilization and Disposal Review. The retention and disposal reviews were being performed in stages that included demand based, nondemand based and nonstocked items. All high-dollar excess items were scheduled for review first, followed by low-dollar demand based items, nondemand based, and nonstocked items.

Based on the September 30, 1992, stratification, nearly 300,000 line items with potential reutilization and disposal materiel totaling $1.5 billion were scheduled for review at the Defense Electronics Supply Center and the Defense Industrial Supply Center. As of April 30, 1993, inventory item managers had reviewed over 100,000 line items and disposed of over $500 million of materiel.

Different retention limits were being used in the inactive item program and the materiel returns program. This often generated automated recoupment of materiel that was recently disposed of. To alleviate the problem, the minimum retention limit was increased to 12 in each program.

Diminishing Manufacturing Source Items. The Defense Electronics Supply Center manages a large number of items that are no longer manufactured or are difficult to procure. The items are included in contingency retention stocks. Items with at least $100,000 of stock and no demand in the last 6 years are scheduled for review during the third quarter of FY 1993. Retention and disposal decisions will be based on data obtained from the Services instead of on the current requirement to retain a minimum of 50 assets for items with no demand in the last 6 years. The Defense Industrial Supply Center does not have any diminishing manufacturing source items.

Appendix E. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Type of Benefit
1.a.	Economy and Efficiency. Remove obsolete and unneeded materiel from the wholesale supply system.	Nonmonetary
1.b.	Internal Control and Compliance. Validate retention quantities for possible disposal of unneeded materiel.	Nonmonetary
2.	Economy and Efficiency. Review all potential reutilization and disposal materiel, regardless of value, before disposal to preclude disposal of needed materiel.	Nonmonetary
3.a.	Compliance. Reclassify numeric retention stocks to appropriate stratification supply levels.	Nonmonetary
3.b.	Internal Control and Compliance. Validate retention quantities for possible disposal of unneeded materiel.	Nonmonetary
4.	Internal Control and Compliance. Remove obsolete and unneeded materiel, held only for possible sale to foreign military customers, from the wholesale supply system.	Nonmonetary
5.	Internal Control and Economy and Efficiency. Validate automated recoupment transactions before initiating the actual recoupment.	Nonmonetary

Appendix F. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Washington, DC

Department of the Army

Office of the Deputy Chief of Staff for Logistics, Washington, DC
U.S. Army Materiel Command, Alexandria, VA
  U.S. Army Communications and Electronics Command, Fort Monmouth, NJ
  U.S. Army Aviation and Troop Command, St. Louis, MO

Department of the Navy

Naval Supply Systems Command, Arlington, VA
  Navy Aviation Supply Office, Philadelphia, PA
  Navy Ships Parts Control Center, Mechanicsburg, PA

Department of the Air Force

Office of the Deputy Chief of Staff for Logistics, Arlington, VA
Air Force Materiel Command, Wright Patterson Air Force Base, OH
  San Antonio Air Logistics Center, San Antonio, TX
  Warner Robins Air Logistics Center, Warner Robins, GA

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Alexandria, VA
  Defense Electronics Supply Center, Dayton, OH
  Defense Industrial Supply Center, Philadelphia, PA
  Defense Reutilization and Marketing Service, Battle Creek, MI

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Assistant to the Secretary of Defense for Public Affairs
Comptroller of the Department of Defense

Department of the Army

Secretary of the Army
Commander, U.S. Army Materiel Command
  Commander, U.S. Army Aviation and Troop Command
  Commander, U.S. Army Communications and Electronics Command
Auditor General

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Naval Audit Service
Commander, Naval Supply Systems Command
  Commanding Officer, Navy Aviation Supply Office
  Commanding Officer, Navy Ships Parts Control Center

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Air Force Audit Agency
Commander, Air Force Materiel Command
  Commander, San Antonio Air Logistics Center
  Commander, Warner Robins Air Logistics Center

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Intelligence Agency
Director, Defense Logistics Agency
  Commander, Defense Electronics Supply Center
  Commander, Defense Industrial Supply Center
Director, Defense Logistics Studies Information Exchange
Inspector General, National Security Agency

Non-Defense Federal Organizations

Office of Management and Budget
U.S. General Accounting Office
- National Security and International Affairs Division, Technical Information Center
- National Security and International Affairs Division, National Aeronautics and Space Administration Management Issues
- National Security and International Affairs Division, Military Operations and Capabilities Issues

Chairman and Ranking Minority Member of each of the following Congressional Committees and Subcommittees:
- 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 Operations
- House Subcommittee on Legislation and National Security, Committee on Government Operations

Part IV - Management Comments

Department of the Army Comments

DEPARTMENT OF THE ARMY
OFFICE OF THE DEPUTY CHIEF OF STAFF FOR LOGISTICS
WASHINGTON DC 20310-0500

DALO-SMP

MEMORANDUM THRU 13 Jan 94 14 JAN 1994

DEPUTY CHIEF OF STAFF FOR LOGISTICS

~~DIRECTOR OF THE ARMY STAFF~~ 14 JAN 94 1/21/94

ASSISTANT SECRETARY OF THE ARMY (INSTALLATIONS, LOGISTICS AND ENVIRONMENT)

FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (AUDITING)

SUBJECT: Draft Audit Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No. 2LD-0047)--INFORMATION MEMORANDUM

1. U.S. Army Audit Agency memorandum of 16 Nov 93 (Tab A) asked ODCSLOG to respond to your memorandum of 8 Nov 93 (Encl to Tab A). Your memorandum requested a report on the status of actions being taken in response to each assigned finding and recommendation.

2. The ODCSLOG's response to your request follows:

RECOMMENDATION 1. We recommend that the Commander, U.S. Army Materiel Command; Commander, Naval Supply Systems Command; and Director, Defense Logistics Agency:

a. Consistently and routinely review all items with potential reutilization and disposal materiel, promptly reclassify materiel that is retained, and dispose of materiel that is obsolete and unneeded.

b. Periodically review all contingency retention stock, and validate and document the reason for the retention and the quantity retained in accordance with DOD policy.

Concur with Recommendation 1a. Future guidance, for the quarterly Budget Stratification, will contain stringent enough parameters to ensure potential reutilization and disposal materiel is thoroughly reviewed for retention or disposal. For the last 2 years the USAMC has, as part of the DOD Inventory Reduction Program, required Item Managers to actively pursue the reduction of unrequired inventory. During FY 92 and FY 93 USAMC

'DALO-SMP
SUBJECT: Draft Audit Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No. 2LD-0047)--INFORMATION MEMORANDUM

sent $2.5 and $2.8 billion in unrequired inventory to property disposal offices.

Concur with Recommendation 1b. Under DOD Inventory Reduction Program, Contingency Retention Levels must be reviewed and justified in the line-item-folder on an annual basis. This requirement will continue to be emphasized in conjunction with the 30 Jun Budget Stratification every year.

RECOMMENDATION 4. We recommend that the Commander, U.S. Army Materiel Command; Commander, Naval Supply Systems Command; and Commander, Air Force Materiel Command promptly identify materiel held specifically for foreign military customers, offer the materiel to foreign military customers (at standard or reduced prices) when no requirement for active weapon systems exist, and finalize all buyouts within the established 1- or 2-year timeframe.

Concur with Recommendation 4. Commander, United States Army Security Assistance Command (USASAC) is currently working with the U.S. Army Materiel Command personnel on an initiative to ensure all excess materiel is offered to foreign military customers with the established 1- or 2-year timeframe. Automation changes at USASAC will ensure the time period is tracked appropriately. Once the "clock" has started, the USASAC managers will notify the USAMC item managers when the 2-year time period has elapsed. The first excess offers are in the process of being reviewed by foreign military customers and action will be taken to either sell/reclassify or dispose of the materiel as appropriate.

The reinstatement of purpose code "N" to the Commodity Command Standard System (CCSS) and Foreign Military Sales (FMS) regulations, proposed NLT 30 Sep 94, will earmark assets in this purpose code for FMS customers. The assets held in this purpose code will be based on survey conducted by Security Assistance. A copy of the FMS survey must be on file at the IMM's location for supervisor/division review. These assets will be held for a maximum of 2 years to allow the FMS customers sufficient time to acquire funding to purchase the assets. The type of assets stored in the purpose code are secondary and major end items. The IMM will review these assets semiannually (Jun and Dec) and provide a report of the assets being held to ODCSLOG no later than 30 days after the end of the reporting period. There will be no exceptions for holding assets in this purpose code for more than 2 years unless a written approval has been received from ODCSLOG.

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DALO-SMP
SUBJECT: Draft Audit Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No. 2LD-0047)--INFORMATION MEMORANDUM

RECOMMENDATION 5. We recommend that the Commander, U.S. Army Materiel Command; Commander, Naval Supply Systems Command; and Director, Defense Logistics Agency require the review of all automated recoupment decisions before initiating the actual recoupment process, or develop automated screening process that precluded the recoupment of unneeded materiel to ensure that the automated decision is appropriate.

Concur with Recommendation 5. USAMC's major subordinate commands will be advised that recoupment transactions require a thorough review of all requirements prior to the generation of a transaction to the DRMO. The present system does not automatically generate any transactions to a DRMO. The automated system generates a transaction to a suspense file for item manager review. If no action occurs within 90 days, that file is purged of all old transactions and the process begins again. The USAMC will direct the item managers to perform a review of all suspended transactions in the Disposal Materiel On-Line Requisitioning System (DMORS) prior to releasing the transactions for processing at the DRMO.

3. The ODCSLOG point of contact for this action is MAJ Bill Guinn, DALO-SMP, 695-7785.

Encl

JOHN J. CUSICK
Brigadier General, GS
Director of Supply
and Maintenance

CF:
VCSA
OASA(I,L&E)
AMCLG-SP

OASA(I,L&E) - Concur, Mr. Croom/75727 (by phone)
AMCLG-SP - Concur, Ms. Reyes/274-3566 (by phone)

Ms. Lee/46760

3

Department of the Air Force Comments

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE

5 JAN 1994

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: AF/LGS

SUBJECT: DoD(IG) Draft Audit Report, Materiel Retention and Disposal Procedures for Secondary Items, November 8, 1993 (Project No. 2LD-0047) - INFORMATION MEMORANDUM

This is in reply to your request for Air Force comments on the subject report.

The Air Force has made significant progress in reducing the amount of inactive stock in its possession. Air Force Materiel Command (AFMC) removed the deferred disposal codes in the September 30, 1992 computation cycle. As a result of the deferred disposal code removal and high level management attention, the Air Force processed over $10 billion in materiel to disposal during fiscal year 1993. Unfortunately, your report is based on findings and data that are almost two years old. Since the final report will not be issued until the spring of 1994, readers outside the Department may inappropriately conclude the Department is not aggressively taking steps to reduce inactive inventory.

In addition, your analysis and findings are based on March 1992 data but you refer to DoD Regulation 4140.1-R which was not published until January 1993. The Air Force implemented the Numeric Retention Stock (NRS) category subsequent to a 1986 DoD stratification improvement conference. The DoD eliminated NRS as a valid retention category in the DoD 4140.1-R. However, the regulation was not distributed to the Components until April 1993 and it did not consider any limitations for current automated information systems. The record should be set straight. The Air Force had attempted to comply with DoD policy, the policy was revised after your data collection, and the Air Force will comply with the revised policy.

We concur with all recommendations directed to the Commander, Air Force Materiel Command. The following actions are being taken:

a. Recommendation 1.a. The Air Logistic Centers on a quarterly basis are using the excess review listing to review all items that have stratified into potential reutilization. AFMC has

removed the weapon system codes and closely monitors the number of items and dollar value of both item assigned and system level codes. Both metrics have shown continuous improvement since March 1992.

b. Recommendation 1.b.: Contingency retention stock is reviewed and documented with the reason for retention at least annually. Command parameters for the established policy are used and dictate the parameters for the reviews. AFMC has issued guidance to the Air Logistics Centers to review Contingency Retention Stock at least annually and reports progress on a quarterly basis.

c. Recommendation 3.a.: Numeric retention stocks for consumable items will be reclassified to appropriate stratification levels when the Materiel Management Standard System (MMSS) currently being developed for the DoD is implemented. Air Force implementation is presently scheduled for October 1995.

d. Recommendation 3.b.: Pending implementation of the Requirements Determination segment of the DoD Materiel Management Standard System, assets stratified as numeric retention stock are being reviewed and validated for retention/disposal in the same manner as contingency retention stock.

e. Recommendation 4: For clarification purposes we recommend the word "excess" be inserted on line three of the recommendation to read "Materiel Command promptly identify excess materiel held specifically for foreign...". AFMC is promptly identifying excess materiel held specifically for foreign military customers as a result of policy implemented in May 1993. The materiel is being offered to foreign customers when no requirement for active weapons systems exist. The buyouts will be finalized within the established one or two year timeframe.

The action officer for this report is Ms Ruth Hill, (703) 695-4514.

MICHAEL SETTLER, COL, USAF
Deputy Director of Supply
Directorate of Logistics

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA VIRGINIA 22304-6100

IN REPLY REFER TO DDAI

19 JAN 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: DoD IG Draft Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No 2LD-0047)

This is in response to your 8 November 1993 request.

4 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Office

cc:
MM

TYPE OF REPORT: AUDIT DATE OF POSITION:

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Draft Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No 2LD-0047)

FINDING: Retention and Disposal Procedures. DoD Components did not review and validate for retention or disposal all potential reutilization and disposal materiel, contingency and numeric retention stocks, and materiel that did not support active weapons systems and was held for foreign military requisitioners only. In some instances, the reviews that were performed were inadequate. Additionally, recoupment programs were not adequate to preclude the recoupment of unneeded materiel. The conditions occurred because inventory item managers established arbitrary review thresholds, automatically disposed of materiel without review and validation, improperly categorized potential reutilization and disposal materiel as retention stocks, or limited retention and disposal reviews to inactive items. Inventory item managers did not require documentation to support retention decisions as required by DoD directive and Air Force activities used deferred disposal codes to preclude the review of retention stocks. Inventory item managers did not comply with DoD guidance. Additionally, automated recoupment programs made inappropriate recoupment decisions based on incorrect requirements data; and the recoupment decisions were not validated by the inventory item manager. For the wholesale supply activities we visited, we estimated that $522 million of potential reutilization and disposal materiel, $560 million of contingency retention stock, and $484 million of numeric retention stock was retained when no longer needed, and $6.4 million of unneeded materiel was recouped when there was no known need.

DLA COMMENTS:

Partially concur. As noted in the body of the report, DLA instituted total review procedures for the retention and disposal programs effective in December 1992. These reviews are conducted to ensure both that retention levels are accurate, and that all necessary disposal actions are initiated promptly. The finding addresses the issue that "inventory managers did not require documentation to support retention decisions as required by DoD Directive.. ". DoD Instruction 4140.1-R, DoD Materiel Management Regulation, stipulates that "item-by-item verification" will be performed for Contingency Retention Stocks. DLA Supply Centers were advised of this requirement in both FY 92 and 93, however formal guidance will be issued to reiterate this procedure. DLA's recoupment process is constructed to provide optimum manual review of potential recoupment actions Based on the audit findings, we concur that a review of this process should be initiated to ensure that existing program checks and manager reviews are appropriate.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: B.K. Meadows, MMSLR, x46388, 1/3/94
REVIEW/APPROVAL: James J. Grady, Deputy Executive Director, Supply Management, MMSD, x70510, 1/3/94
COORDINATION: Anthony Broadnax, DDAI, x49607, 1/10/94

DLA APPROVAL:

14 JAN 1994

LAWRENCE P. FARRELL, JR
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION:

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Draft Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No. 2LD-0047)

RECOMMENDATION 1.A: We recommend that the Director, Defense Logistics Agency consistently and routinely review all items with potential reutilization and disposal materiel, promptly reclassify materiel that is retained, and dispose of materiel that is obsolete and unneeded.

DLA COMMENTS: Partially Concur. Effective December 1992, DLA instituted an aggressive Disposal Program which requires review of all items as delineated in the Recommendation. Annual on-site reviews are conducted to ensure appropriate oversight.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(X) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

MONETARY BENEFITS: N/A
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: B.K. Meadows, MMSLR, x46388, 1/3/94
REVIEW/APPROVAL: James J. Grady, Jr., x470510, 1/3/94
COORDINATION: A. Broadnax, DDAI, X49607, 1/10/94

DLA APPROVAL:

14 JAN 1994

TYPE OF REPORT: AUDIT DATE OF POSITION:

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Draft Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No 2LD-0047)

RECOMMENDATION 1.B: We recommend that the Director, Defense Logistics Agency periodically review all contingency retention stock, and validate and document the reason for the retention and the quantity retained in accordance with DoD policy.

DLA COMMENTS: Partially Concur. Individual Supply Centers were verbally directed during FY 93 to review assets held in Contingency Retention on an annual basis, and that written justification for such levels would be required on an NSN basis. Formal policy guidance to this effort will be issued in FY 94.

DISPOSITION:
(X) Action is ongoing. Estimated Completion Date: 30 Jun 94
( ) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

MONETARY BENEFITS: N/A
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: B.K. Meadows, MMSL, x46388, 1/3/94
REVIEW/APPROVAL: James J. Grady, Deputy Executive Director, Supply Management, MMSD, x70410, 1/3/94
COORDINATION: A. Broadnax, DDAI, x49607, 1/11/94

DLA APPROVAL:

JAN 1994

TYPE OF REPORT: AUDIT DATE OF POSITION:

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Draft Report on Materiel Retention and Disposal Procedures for Secondary Items (Project No. 2LD-0047)

RECOMMENDATION 5: We recommend that the Director, Defense Logistics Agency require the review of all automated recoupment decisions before initiating the actual recoupment process, or develop an automated screening process that precludes the recoupment of unneeded materiel to ensure that the automated decision is appropriate.

DLA COMMENTS: Partially Concur. DLA's recoupment process currently requires review of potential (automated) recoupment decisions, with a $1000 threshold in place to ensure no adverse resource impact. In order to validate the effectiveness and efficiency of this process, DLA will direct the Supply Center to review current program logic and provide any recommendations for adaptations to preclude the problems cited in the audit. Corrective action will be taken, if necessary, following this process.

DISPOSITION:
(X) Action is ongoing. Estimated Completion Date: 30 Sep 94
( ) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.) See above comments.
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

MONETARY BENEFITS: N/A
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: B.K. Meadows, MMSLR, x46388, 1/3/94
REVIEW/APPROVAL: James J. Grady, Jr., Deputy Executive Director, Supply Management, MMSD, x70510, 1/3/94
COORDINATION: A. Broadnax, DDAI, x49607, 1/10/94

DLA APPROVAL:

14 JAN 1994

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