# Audit Report

## DEFENSE LOGISTICS AGENCY CUSTOMER RETURNS IMPROVEMENT INITIATIVE PROGRAM

Report No. D-2001-002 October 12, 2000

Office of the Inspector General
Department of Defense

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**Acronyms**

| | |
|---|---|
| CRII | Customer Returns Improvement Initiative |
| DLA | Defense Logistics Agency |

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2885

October 12, 2000

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Defense Logistics Agency Customer Returns Improvement Initiative Program (Report No. D-2001-002)

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

The Defense Logistics Agency comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Nicholas E. Como at (703) 604-9215 (DSN 664-9215) (ncomo@dodig.osd.mil) or Mr. Terry L. McKinney at (703) 604-9288 (DSN 664-9288) (tmckinney@dodig.osd.mil). See Appendix C for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

## Office of the Inspector General, DoD

**Report No. D-2001-002** **October 12, 2000**
(Project No. D2000CF-0111)

# Defense Logistics Agency Customer Returns Improvement Initiative Program

## Executive Summary


**Introduction.** This is one of two reports being issued by the Inspector General, DoD, which addresses various aspects of the Defense Logistics Agency Product Verification Program. This report addresses the management of the Customer Returns Improvement Initiative Program. This program was established in August 1997 to reduce the likelihood that potentially defective assets would be returned to Defense Logistics Agency depots. As of May 2000, the agency's Defense Supply Centers listed over 5,700 types of assets subject to screening procedures if received as customer returns.

**Objectives.** The overall objective was to determine whether the Defense Logistics Agency was effectively managing the Product Verification Program. Specifically, the audit was to determine how products were selected for testing and whether the program's testing plan was adequate. The audit also determined whether the Product Verification Program managers and quality assurance specialists were using the test results to purge nonconforming inventory from the Defense Logistics Agency depots and whether contractor problems were identified. This report discusses the methods that the Defense Logistics Agency used to screen nonconforming inventory. In a subsequent report, we will discuss the other objectives as well as the Defense Logistics Agency's management control program as it relates to product testing.

**Results.** The Defense Logistics Agency did not fully implement the Customer Returns Improvement Initiative Program. Therefore, all depots could not screen and suspend potentially nonconforming assets received through customer returns. The Defense Supply Centers did not regularly transmit listings of nonconforming assets to the depots that participated in the program, nor did they consistently provide all necessary information to distinctly identify the assets. As a result, as many as 28 percent of the Defense Logistics Agency's returned assets, comprised of over 176,000 individual supplies and spare parts that had been identified as potentially defective and returned to the depots, were not screened and could be reissued to customers without qualification. Conversely, the lack of detailed information on nonconforming assets forwarded to the depots may have resulted in some assets being unnecessarily suspended.

**Summary of Recommendations**. We recommend that the Director, Defense Logistics Agency establish the Customer Returns Improvement Initiative Program in all depots; issue timely and updated information about nonconforming assets to the depots; and submit detailed information on nonconforming assets to the depots.

**Management Comments.** The Defense Logistics Agency generally agreed with the recommendation to establish the Customer Returns Improvement Initiative Program in all depots. The agency stated that the Customer Return Improvement Initiative Program was only instituted at the two Primary Distribution Sites because these depots also operate a product test center that can inspect suspected customer returns for technical conformance. The Defense Logistics Agency further commented that it would be fiscally imprudent to establish a product test center at each depot. Nevertheless, the Defense Logistics Agency agreed to implement screening of all Customer Returns Improvement Initiative returns; use the most cost effective means to verify technical performance prior to processing questioned items into issuable inventory status; update the listing of potentially nonconforming assets on a quarterly basis; and provide additional identifying information on potentially nonconforming assets to the depots. See the Finding section of the report for a discussion of management comments and to the Management Comments section of the report for the complete text of the comments.

**Audit Response.** The Defense Logistics Agency comments are responsive to our recommendations. We did not recommend establishing product test centers in conjunction with the Customer Returns Improvement Initiative Program at each depot. We recommended establishing an effective program at all depots for screening potentially nonconforming assets received through customer returns.

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## Introduction

This is one of two reports being issued by the Inspector General, DoD, which addresses various aspects of the Defense Logistics Agency (DLA) Product Verification Program. This report addresses the management of the Customer Returns Improvement Initiative (CRII) Program.

## Background

**Product Verification Program.** The Product Verification Program was established with the creation of DLA Directive 4105.20, "Product Verification Program for Inventory Control Points," January 20, 1995, to consolidate test program management and activities for improved efficiency, consistency and reduced operational cost. Each Defense Supply Center establishes and maintains a Product Verification Program to identify assets that do not meet technical requirements. The DLA directive mandates that tests be conducted on a random and directed basis.

**Customer Returns Improvement Initiative Program.** The CRII program was established in August 1997. The CRII is managed by the Headquarters, DLA Product Verification Program Office and was established to reduce the likelihood that DLA depots received nonconforming returned assets. Items having a history of past customer complaints were selected for inspection and testing. Quality assurance specialists, responsible for ensuring that products conform to established technical requirements, provide specific instructions to depot personnel to identify failed specifications reported by customers. Customer complaints are logged into the automated Distribution Standard System. The automated system was designed to process depot asset transactions. As of May 2000, the agency's Defense Supply Centers listed over 5,700 potential assets subject to screening procedures if received as customer returns. This program was established at three Defense Supply Centers and two DLA primary distribution sites or prime depots: San Joaquin, California, and Susquehanna, Pennsylvania.

## Objectives

The overall objective was to determine whether DLA was effectively managing the Product Verification Program. Specifically, this report discusses the methods DLA used test results relating to the CRII program to keep nonconforming assets from its inventory and ultimately from its customers. We will discuss the management control program in a subsequent report.

# Customer Returns Improvement Initiative Program

Headquarters, Defense Logistics Agency limited the effectiveness of the Customer Returns Improvement Initiative Program by not extending the program to all depots. In addition, the depots that participated in the program did not receive information to distinctly identify the assets, or the information was not regularly transmitted. These deficiencies occurred because the program was limited to the prime depots and procedures were not established to uniformly and consistently notify the depots of nonconforming assets. As a result, as many as 28 percent of the Defense Logistics Agency returned assets, comprised of over 176,000 individual assets that were identified as potentially defective and received through customer returns, were not screened and eliminated from inventory. Conversely, some assets may have been unnecessarily suspended from distribution.

## Customer Return Policy

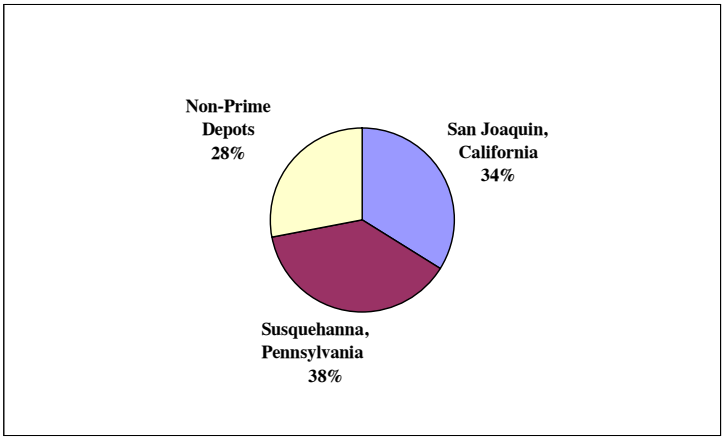
**Program Implementation.** Product Quality Deficiency Reports have been used for several years to report deficiencies in government-owned products, materials, and equipment back to the Defense Supply Centers. The Defense Supply Centers developed and maintained the CRII listing of nonconforming (potentially defective)[1] assets based on the reports and recommendations from quality assurance specialists and military customers. The CRII listing was forwarded to the depots for entry into the Distribution Standard System. All available information from the listings describing the asset deficiency was entered into the Distribution Standard System at the depot. When assets were received through customer returns at the depot, personnel responsible for receipt and inspection of assets checked the Distribution Standard System for special suspension or disposition instructions and directed the action accordingly.

## Application of the Customer Returns Program

**Defense Supply Centers Listings.** Assets that were selected for inspection had a history on at least one Product Quality Deficiency Report detailing the customer complaint. Quality assurance specialists also assigned assets with previous contractor or quality problems to the program. The program listings were compiled for those assets managed at each Defense Supply Center. As of May 2000, there were over 5,700 assets from the supply centers listings that were subject to review in this program.

[1] Nonconforming refers to failure to meet prescribed specifications, standards or other contractual requirements related to quality or function.

**Limited Application of the Customer Returns Program**. DLA administered the CRII program on a limited basis. Listings of nonconforming customer returned assets were submitted to the following prime depots, or primary distribution sites: San Joaquin (Tracy and Sharpe Depots, California), and Susquehanna (Mechanicsburg and New Cumberland Depots, Pennsylvania). Non-prime depots (depots not designated as primary distribution sites) were not part of the program. DLA contended that when the program originated, non-prime depots had not implemented the Distribution Standard System. As of May 2000, all DLA depots have implemented this automated system. In addition, DLA maintained that the majority of customer returns were sent to the prime depots. However, 3,900 FY 1999 customer returns of CRII assets, comprised of over 176,000 individual assets, were returned to the 22 non-prime depots and were not subject to review. The following figure shows that 28 percent of the FY 1999 customer returns of CRII assets were returned to the non-prime depots.




**Percentage of Customer Returns on Nonconforming Assets During FY 1999, Prime Versus Non-Prime Depots**

## Customer Returns at Non-Prime Depots

We visited two DLA non-prime depots at Norfolk, Virginia, and Red River, Texas. These depots received 964, or 25 percent of the 3,900 customer returned CRII assets to all non-prime depots for FY 1999.

**Defense Distribution Depot, Norfolk Procedures.** Defense Distribution Depot, Norfolk has a program in place to identify nonconforming Navy customer returned assets. The Naval Inventory Control Point has submitted a Defective Material Summary listing, consisting of Navy-managed nonconforming assets to the Norfolk Depot since March 2000. The asset listings were manually entered into the depot's Distribution Standard System. The Norfolk Depot program for screening nonconforming assets mirrored the CRII program procedures outlined for the prime depots.

**Defense Distribution Depot, Norfolk Review Results.** Our review at the Defense Distribution Depot, Norfolk was limited to assets returned to the depot that were managed by the Defense Supply Center, Columbus. We examined 282 of the 634 customer returned assets, comprising 151 individual assets, that were returned to the depot to determine whether the assets were suspended until their condition was evaluated or whether the assets had been reissued without reservation. Tables 1 and 2 show the results of the two reviews.

**Table 1. Customer Returned Assets – Norfolk Depot**

| | Customer Returned Assets | Percent |
|---|---|---|
| Not Suspended | 272 | 96 |
| Suspended | 10 | 4 |
| **Total** | 282 | 100 |

**Table 2. Potentially Nonconforming Assets Reissued to Customers – Norfolk Depot**

| | Customer Returned Assets | Percent |
|---|---|---|
| Not reissued to customers | 68 | 24 |
| Reissued to customers | 214 | 76 |
| **Total** | 282 | 100 |

DLA may have reissued nonconforming returned assets to customers by limiting the distribution of the CRII Program listing to the prime depots.

**Defense Distribution Depot, Red River Procedures.** The Red River Depot also had a program in place for identifying nonconforming customer returned assets. DLA material managers, quality assurance specialists, and customers periodically notified the Red River Depot of potentially nonconforming assets that should be inspected upon receipt. Upon notification, the assets and descriptions of the deficiencies were entered into the Red River Distribution Standard System. The Red River Depot program for screening nonconforming assets also mirrored the CRII program procedures outlined for the prime depots.

**Defense Distribution Depot, Red River Review Results.** We expanded our analysis at the Red River Depot to include all nonconforming CRII assets identified at the three supply centers. We examined Defense Distribution System transaction histories for the 272 of the 330 customer returned assets, comprising 163 individual assets that were returned to the depot to determine whether the assets were suspended until their condition was evaluated or whether the assets had been reissued without reservation. Tables 3 and 4 show these results.

**Table 3. Customer Returned Assets – Red River Depot**

| | Customer Returned Assets | Percent |
|---|---|---|
| Not suspended | 260 | 96 |
| Suspended | 12 | 4 |
| **Total** | 272 | 100 |

**Table 4. Potentially Nonconforming Assets Reissued to Customers – Red River Depot**

| | Customer Returned Assets | Percent |
|---|---|---|
| Not reissued to customers | 25 | 9 |
| Reissued to customers | 247 | 91 |
| **Total** | 272 | 100 |

We also visited the Red River Depot storage facilities to determine whether nonconforming assets were on-hand and available for issue. We photographed seven of the assets that should have been suspended but were found available for issue. (See Appendix B for a photograph and description of the seven assets). DLA may have reissued nonconforming assets to customers by limiting the distribution of the CRII Program listing to the prime depots.

## Customer Returns at a Prime Depot

**Defense Distribution Depot, San Joaquin Procedures.** The San Joaquin Depot received CRII asset listings from the supply centers and properly entered the nonconforming assets and the deficiency descriptions, if available, into the Distribution Standard System. When assets were returned to the San Joaquin

Depot, responsible depot personnel queried the Distribution Standard System to determine whether suspension or distribution instructions were noted. If the customer returned asset was included in the CRII program, the asset was properly suspended from future issues or properly disposed.

**Defense Distribution Depot San Joaquin Review Results.** For FY 1999, the Defense Distribution Depot San Joaquin received 2,911 CRII customer returned assets. We selected 110 customer returned assets. Eighteen assets were returned before the asset appeared on the CRII listing and no further review was completed. We reviewed transaction histories for the remaining 92 customer returned assets to determine whether the assets were properly suspended and found that only seven of the customer returned assets were not properly suspended. The seven customer returned assets were subsequently reissued to customers. The seven returned assets that were not suspended were attributed to personnel oversight at the depot, and not a systemic deficiency. We brought this issue to the attention of responsible depot command personnel and no further action is required.

We reviewed 10 assets at the depot storage areas to ensure that the suspended assets were physically segregated from assets available for issue. All 10 San Joaquin Depot suspended assets that were reviewed were properly segregated in designated areas and included the proper quantity of items in suspension.

## Improvements in the Notification to Depots

**Information Provided to the Depots.** The Defense Supply Centers provided varying degrees of detail with their respective CRII listings. The Defense Supply Center, Columbus, provided the most detail involving the CRII listings. The Columbus center provided the national stock number, a brief description of the asset deficiency, and the contract number of the item, if known. The Philadelphia Supply Center provided the national stock number and the contract number, if known. The Richmond Supply Center only provided the national stock number. The San Joaquin Depot suspended 873 of the Richmond center's FY 1999 customer returns because additional information that would isolate the nonconforming asset to a specific source was not always provided. Suspending all assets without identifying a specific contractor or contract number may be causing some assets to be unnecessarily suspended.

**Frequency of Reporting CRII Listings.** We found that the San Joaquin Depot had not received any CRII listings for assets managed by the Philadelphia or Richmond centers for 14 and 15 months, respectively. The Philadelphia and Richmond centers tested 2,824 assets that resulted in 240 test failures in FY 1999. The CRII program listings would have been most likely increased as a result of test failures, yet these centers had not provided the San Joaquin Depot updated listings of CRII assets since March and April 1999, respectively.

## Conclusion

Conceptually, the CRII was an effective process to prevent DLA depots from reissuing nonconforming customer returned assets. System-wide application of the CRII was needed because 28 percent of CRII returned assets were received by the non-prime depots. Since all depots implement the Distribution Standard System, minimal training or additional personnel would be needed to expand the program to the non-prime depots.

## Recommendations, Management Comments and Audit Response

**We recommend that the Director, Defense Logistics Agency:**

1. **Establish the Customer Return Improvement Program in all depots.**

**Management Comments.** DLA generally concurred and stated that the primary reasons that the Customer Return Improvement Program was only instituted at the Primary Distribution Sites were because these sites have received the majority of the returned assets and that only the Primary Distribution Sites operate a product test center. The product test centers have the capability to inspect suspected customer returns for technical conformance. DLA further stated that it was not cost effective to establish a product test center for each depot.

**Audit Response.** DLA comments to this recommendation are responsive. We did not recommend establishing product test centers in conjunction with the Customer Return Improvement Program at each depot. We recommended establishing an effective program at all depots for screening potentially nonconforming assets received through customer returns.

2. **Issue timely and updated CRII listings to all depots.**

3. **Direct that the Defense Supply Centers submit documentation on nonconforming assets to include:**

   a. Contractor and contract numbers, if known;

   b. A brief description of the asset deficiency; and

   c. A point of contact responsible for the management of the nonconforming asset.

**Management Comments.** DLA concurred and will direct the Product Verification Managers, located at the DLA Supply Centers, to update their Customer Returns Improvement Initiative listing of potentially conforming assets on a quarterly basis. DLA concurred and stated that a proposed data system enhancement would provide additional information directly to the receiving examiner at the depots.

# Appendix A. Audit Process

## Scope

**Work Performed**. We reviewed and evaluated the administration of the CRII Program at the Defense Supply Centers and the depots. A list was compiled of CRII assets that were returned during FY 1999 to the depots visited. We examined Distribution Standard System transaction histories to determine whether the assets were suspended when returned to the depots and whether the assets were subsequently reissued. The date of the customer return action was compared to the date the asset was originally listed on the Defense Supply Centers CRII Program listing. If the return occurred before the asset was placed on the CRII listing, the return was disregarded from further review. For the remaining customer return actions, we determined whether the assets were properly suspended and whether they were subsequently reissued. Current screening procedures for identifying nonconforming customer returns at the depots were evaluated. From this information, we analyzed whether expansion of the CRII program depot-wide would be justifiable and feasible given the current capabilities of the non-prime depots.

**Limitations to Scope**. Our scope was limited in that we did not include tests of the management control program. A subsequent report will discuss the adequacy of the Product Verification Program management controls as applicable to the primary audit objective.

**DoD-Wide Corporate Level Government Performance and Results Act (GPRA) Goals.** In response to the GPRA, the Secretary of Defense annually establishes DoD-wide corporate level goals, subordinate performance goals, and performance measures. This report pertains to achievement of the following performance measure:

**FY 2000 Performance Measure 2.3.5:** Visibility and Accessibility of DoD Material Assets.

**General Accounting Office High-Risk Area.** The General Accounting Office has identified several high-risk areas in the DoD. This report provides coverage of the defense inventory management high-risk area.

## Methodology

**Use of Computer-Processed Data.** We relied on computer-processed data from the Standard Automatic Material Management System and the Distribution Standard System. From the Standard Automatic Material Management System, we obtained customer returned CRII assets during FY 1999 and their relevant condition code and depot location. From the Distribution Standard System, we determined whether CRII assets were suspended upon their return and whether the potentially nonconforming assets were reissued. Although we did not

perform a formal reliability assessment of the computer-processed data, we determined that the date of the customer return, document number and condition codes agreed with the information in the computer-processed data. We did not find errors that would preclude use of the computer–processed data to meet the audit objectives, or that would change the conclusions in this report.

**Audit Type, Dates, and Standards.** We performed this program audit from March through June 2000 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD.

**Contacts During the Audit.** We visited or contacted individuals within DoD. Further details are available upon request.

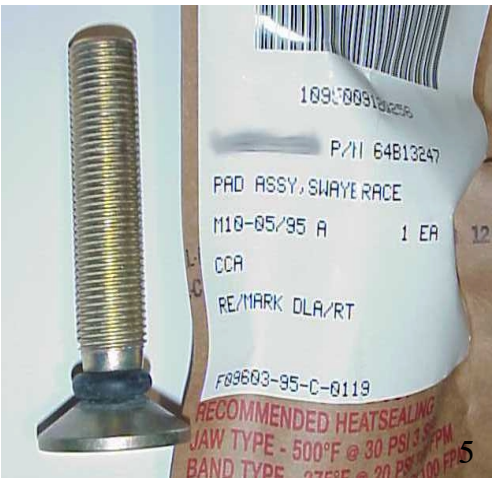
## Prior Coverage

No prior coverage has been conducted on the Product Verification Program in the last 5 years.

# Appendix B. Nonconforming Assets Available for Issue

The following assets were photographed at the Defense Distribution Depot, Red River, Texas. These assets were available for issue, however, they should have been suspended upon return to the depot.

1. Actuator assembly used on Browning 50 caliber machine gun, needs rivet verification.
2. Flash suppressor used on M-16 machine gun, needs dimensions verification.
3. Emergency exit light, vehicular light fixture, all returns suspended.
4. Straight tube or hose adapter, used on Boeing Vertolcargo Transport Helicopter, needs fittings verification.

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6

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5. Pad assembly sway brace used on an F-15 bomb rack, verify items machined per drawings, suspend returns.
6. Cantilever mounting hub used on the A-10 aircraft, all returns suspended.
7. Globe valve, multipurpose high-pressure valve for oil, gas or water, verify completeness, suspend for testing.

# Appendix C. Report Distribution

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# Defense Logistics Agency Comments

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IN REPLY REFER TO J-3

SEP 21 2000

MEMORANDUM FOR DDAI

SUBJECT: Defense Logistics Agency Customer Returns Improvement Initiative Program, Project No. D2000CF-0111, July 19, 2000

As requested in your memorandum dated July 25, 2000, attached are J-3's comments on the subject report.

D. H. STONE
Rear Admiral, SC, USN
Director
Logistics Operations

Attachment

Federal Recycling Program

**SUBJECT:** Defense Logistics Agency Customer Returns Improvement Initiative Programs, Project No. D2000CF-0111, July 19, 2000

Your memorandum dated July 26, 2000, subject as above, provided a copy of the DoD IG draft report on the DLA Customer Returns Improvement Initiative Program for our review and comment. Our comments follow.

**Finding:** The Defense Logistics Agency limited the effectiveness of the Customer Returns Improvement Initiative Program by not administering the program to all depots. As a result, as much as 28 percent of DLA's managed assets were not screened and eliminated from inventory. (See page 2 for details.)

**DLA Comments:** We partially concur with the finding. The Customer Returns Improvement Initiative (CRII) was established at both of DLA's Primary Distribution Sites (PDSs) because that's where the vast majority of customer returns are received. In support of CRII, two of our organic product testing centers (PTCs) are collocated at the two PDSs. These ISO accredited PTCs provide us with the on site capability to inspect for technical conformance suspect customer returns at the receiving point. This capability permits process compression through the receiving function for over 70% of all customer returns. This economy of scale also provides DLA with an acceptable return on investment and a cost effective method of screening material already classified as conforming by DLA customers prior to its return.

The remaining minority of returns not processed through the PDSs, are spread throughout all other DLA depots. It would not be fiscally prudent for DLA to build a PTC at all of the other depots to inspect the relatively small amount of customer returns processed by them. However, we concur that a method to effectively screen these items is required. This methodology is defined in response to recommendation 1.

**Recommendation No. 1:** The DoDIG recommends that the Director, Defense Logistics Agency establish the Customer Return Improvement Program in all depots.

**DLA Comments:** Partially concur. Although DLA will not build a technical inspection capability at each depot, a method will be implemented to effectively screen all CRII returns and to use the most cost effective laboratory or testing center to verify technical conformance prior to processing any CRII items into issueable inventory status.

A Distribution Standard System (DSS) system change request is being processed which enhances both the exclusionary screen length and distribution of the CRII listing to all DLA Depots. The SYSTEM CHANGE REQUEST will provide DLA with the capability to mass load and update CRII listings to all DLA depots. Any CRII item received at any depot will have specific receiving processing instructions in the DSS exclusionary screen.

The Defense Distribution Command (DDC) is currently providing instructions to all depots to process CRII items into condition code K (Suspended Returns) and to report to the managing Supply Center for inspection/disposition instructions. This will provide an effective screening of CRII items received to other than the PDSs. Based on the need for the material, the responsible item manager will decide to either process the material to a Defense Reutilization and Marketing Office (DRMO) or request conformance verification through the Product Verification Office.

**Recommendation No. 2:** The DoDIG recommends that the Director, Defense Logistics Agency issues timely and updated CRII listing to all depots.

**DLA Comments:** Concur. We will direct the Product Verification Managers located at the DLA Supply Centers to update their CRII listing on a quarterly basis.

**Recommendation No. 3:** The DoDIG recommends that the Director, Defense Logistics Agency, direct that the Defense Supply Centers submit documentation of nonconforming assets to include:

a. contractor and contract numbers, if known;

b. a brief description of the asset deficiency; and

c. a point of contact responsible for the management of the nonconforming asset.

**DLA Comments:** Concur. The DSS system change request outlined in our response to recommendation 1 also calls for expansion of the exclusionary screen to a full page. This system enhancement will allow communication of additional information outlined in the recommendation directly to the receiving examiner.

Action Officer: Michael Shields, (703) 767-2629
Approval: Thomas J. Ridgway, Chief
Technical Services Division
Coordination: Annell W. Williams, DDAI

# Audit Team Members

The Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD, prepared this report. Personnel of the Office of the Inspector General, DoD, who contributed to the report are listed below.

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