Audit Report

INVENTORY VALUATION AT THE
DEFENSE SUPPLY CENTER PHILADELPHIA

Report No. D-2001-146 June 21, 2001

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Acronyms

DEPMEDS	Defense Medical System
DISMS	Defense Integrated Subsistence Management System
DLA	Defense Logistics Agency
DSCP	Defense Supply Center Philadelphia
DVD	Direct Vendor Delivery
GFM	Government Furnished Materiel
NIRF	National Inventory Record File
NSN	National Supply Number
SAMMS	Standard Automated Material Management System
SPMF	Standard Pricing Master File

INSPECTOR GENERAL
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June 21, 2001

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Inventory Valuation at the Defense Supply Center Philadelphia (Report No. D-2001-146)

We are providing this report for review and comment. We performed the audit in support of the requirements of the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The comments received from the Defense Logistics Agency were generally responsive to the recommendations. However, comments were only partially responsive to Recommendations A.1.a., A.1.c., B.1.c., B.1.e, and B.4. and comments to Recommendation A.4. and B.2. were not responsive. Therefore, we request that the Director provide additional comments to Recommendations A.1.a., A.1.c., A.4., B.1.c., B.1.e., B.2., and B.4. by August 20, 2001.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Mr. James L. Kornides at (614) 751-1400, extension 11 (jkornides@dodig.osd.mil) or Ms. Amy J. Frontz at (614) 751-1400, extension 13 (afrontz@dodig.osd.mil). See Appendix D for report distribution. See the inside back cover for a list of audit team members.

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Report No. D-2001-146 **June 21, 2001**
(Project No. D2000FJ-0067.004)

Inventory Valuation at the Defense Supply Center Philadelphia

Executive Summary

Introduction. The Defense Supply Center, Philadelphia, Pennsylvania, is the lead control point for inventories of subsistence and non-subsistence items. Subsistence items include perishable and semi-perishable food items. Non-subsistence items include clothing and textiles, general and industrial items, and medical supplies. The Supply Center managed more than 1.8 million different subsistence and non-subsistence items at the end of FY 2000. The Supply Center reported non-subsistence inventories of about $1.8 billion and subsistence inventories of about $190 million. Collectively, those inventories represented 21 percent of the $9.4 billion of inventory Defense Logistics Agency (DLA) reported on its FY 2000 Financial Statements.

Objectives. The objective was to determine whether the values the Defense Supply Center Philadelphia assigned to subsistence and non-subsistence inventories were accurately computed in accordance with generally accepted accounting principles and were supported by contract data. We also evaluated applicable management controls. See Appendix A for a discussion of the scope and methodology, the management control program, and prior audit coverage.

Results. For its non-subsistence items, the Defense Supply Center Philadelphia assertion that inventory valuation was both accurate and supported by contract data was not reliable. Of the 728* non-subsistence items statistically selected for review, the values assigned to 599 items (82.3 percent) were not accurately computed based on the latest representative obligations or were unsupported. Specifically, 194 items valued at $10 million had acquisition costs that were inaccurate, 28* items valued at $2.9 million had acquisition costs that were not supported by obligation history records, and 377 items valued at $13.9 million had acquisition costs that were based on obligation history records that could not be verified to the originating contract files (finding A).

For the subsistence commodity, the Defense Supply Center Philadelphia assertion that inventory valuation was both accurate and supported by contract data was not reliable. Of the 81 items selected for review with on-hand inventories valued at $204 million, the

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*The sample used in this report was developed by DLA. However, the DLA's sample of 729 items at Defense Supply Center Philadelphia included a non-DLA managed item. As a result, we removed one item originally reported in the 29 items without supporting obligation history records from our audit results.

values assigned to 49 items, valued at $192 million, were not accurately computed based on the latest representative obligations or fully supported by the originating contract files (finding B). Until the deficiencies leading to the inaccurate and unsupportable acquisition costs are corrected and fully disclosed, inventory valuation data from the Defense Supply Center Philadelphia for about $2 billion of inventory cannot be relied upon to support the inventory amounts reported on the DLA financial statements.

Summary of Recommendations. We recommend that the Commander, Defense Supply Center Philadelphia, develop and implement procedures to accurately compute acquisition costs based on the latest representative purchase price and identify and correct the acquisition costs in the national inventory record file that were computed using the inaccurate methods identified by this audit. We recommend that the Commander identify and disclose the amount of on-hand inventories that were valued based on acquisition costs that cannot be supported by contract data. We recommend that the Commander estimate acquisition costs for items without a procurement history based on guidance provided in DoD Regulation 7000.14-R, "DoD Financial Management Regulation," December 1994. We also recommend that the Commander develop and implement procedures to retain contract data to support the acquisition costs used to value on-hand inventories on the financial statements in accordance with DLA contract retention requirements.

Management Comments. The Director, DLA Logistics Operations, concurred or partially concurred with all recommendations. The Director disagreed with 377 items included in our results. He stated that most of the contracts for those items were outside the retention period. He also implied that valuation information was available from other electronic sources. He disagreed with two of the subsistence examples and stated that we did not use a representative buy. He agreed to ensure the inventory valuation methodology is fully documented, review updates to the national inventory record file, and eliminate acquisition costs based on canceled contracts. He also agreed to develop a sampling plan to test the accuracy of prices and to evaluate the cost and benefits of disclosure of the values of on-hand inventory where contract data do not support acquisition costs. Although the Director partially concurred with the recommendation on developing retention procedures for supporting data, he stated that contracts were retained in accordance with Federal Acquisition Regulation guidelines. See the findings for a complete discussion of management comments and the Management Comments section for the complete text of the comments.

Audit Response. The Director's comments were partially responsive to the recommendations. We included the 377 items because supporting contract files were not available for us to review, and we could not make a determination about the reasonableness of the acquisition cost. We based our conclusion about the two subsistence examples on DLA's criteria for latest representative buy. The Director's comments did not address retention of obligation history records in the Standard Automated Material System Pricing System. Also, the DLA needs to issue policy to ensure that its Inventory Control Points comply with Federal Acquisition Regulation requirements and require that these procedures are incorporated into any automated contract folder initiatives. We request that the Director provide additional comments on the final report by August 20, 2001.

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Background

We performed this audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994. This report is the third in a series of reports on the valuation of Defense Logistics Agency (DLA)-owned inventory.

Inventories and inventory-related transactions represent major portions of the total assets, obligations, revenue, and expenses reported on the DLA financial statements. Underlying the financial statements are management assertions on the valuation, ownership, existence, completeness, and presentation of inventories. Assertions regarding inventory valuation deal with whether inventories have been included in the financial statements at the appropriate dollar amounts and whether the basis of valuation is appropriate, properly applied, and consistent with previous periods.

The DLA provides centralized management of consumable spare parts, food, clothing and textiles, and medical supplies through its inventory control points, which are located at its Defense Supply Centers in Columbus, Ohio; Philadelphia, Pennsylvania; and Richmond, Virginia. The inventory control points are responsible for maintaining accurate and reliable inventory values.

This report focuses on our efforts to validate the inventory values in the logistics feeder systems at the Defense Supply Center, Philadelphia, Pennsylvania (DSCP). The DSCP is the lead control point for inventories of subsistence and non-subsistence items. Subsistence items include perishable food and semi-perishable food items, such as meals ready to eat. Non-subsistence items include clothing and textiles, general and industrial items, and medical supplies. The Supply Center managed more than 1.8 million different subsistence and non-subsistence items. At the end of FY 2000, DSCP reported non-subsistence inventories of about $1.8 billion and subsistence inventories of about $190 million. Collectively, those inventories represented 21 percent of the $9.4 billion of inventory DLA reported on its FY 2000 Financial Statements.

Objectives

The objective of the audit was to evaluate management assertions for valuation, completeness, and existence of DoD inventory accounts and to determine whether the financial statements presented the accounts fairly. Two prior audit reports focused on the existence and completeness assertions. This part of the audit focused on the valuation assertion. The objective was to determine whether the values assigned to inventories that the DSCP managed accurately computed in accordance with generally accepted accounting principles and were supported by contract data. We also evaluated applicable management controls. See Appendix A for a discussion of the scope and methodology, the management control program, and prior audit coverage.

A. Inventory Valuation of Defense Supply Center Philadelphia Non-Subsistence Items

The assertion that inventory valuation for non-subsistence items was both accurate and supported by contract data at the DSCP was not reliable. Our analysis of the acquisition costs of 728[1] items included in the DLA statistical sampling plan to measure the dollar value accuracy of the inventory showed that 599 items (82.3 percent) were not accurately computed based on the latest representative obligation or fully supported by the originating contract files. Specifically,

- 194 items valued at $10 million had acquisition costs that were inaccurate.
- 28 items valued at $2.9 million had acquisition cost that were not supported by obligation history records.
- 377 items valued at $13.9 million had acquisition costs that were based on obligation history records that could not be verified to the originating contract files.

The conditions occurred because procedures were not in place to compute acquisition costs based on the latest purchase cost information, to disclose unsupported cost data used, and to retain supporting contract data. Additionally, DSCP had not established a quality assurance program for inventory prices. As a result of the errors, the non-subsistence commodities were understated by $486,336. Inaccurate and unsupported acquisition costs are probable in material amounts in the DSCP-managed items we reviewed. Our analysis of the $1.8 billion of FY 2000 DSCP non-subsistence inventories showed that 235,390 of the items valued at $665.6 million had acquisition costs that were coded as being developed in the same manner as those found to be inaccurate and unsupported by our limited review. Until the deficiencies leading to the inaccurate and unsupported acquisition costs are corrected and fully disclosed, DSCP inventory valuation data cannot be relied upon to support the inventory amounts reported on the DLA financial statements.

[1] The sample used in this report was developed by DLA. However, the DLA sample of 729 items at DSCP included a non-DLA managed item. As a result, we removed one item originally reported in the 29 items without supporting obligation history records from our audit results.

Managing Non-Subsistence Items

DSCP used the Standard Automated Material Management System (SAMMS) to manage its non-subsistence inventories. Within the SAMMS distribution subsystem, the national inventory record file (NIRF) contains the total on-hand asset balance and acquisition cost for each national supply number (NSN) that DSCP managed. In addition, NIRF contains each item's acquisition cost that should be derived from the SAMMS Pricing System. At the end of each reporting period, the total DSCP-owned assets are multiplied by the acquisition cost to arrive at the extended inventory value for each item. The extended inventory value for all DSCP-managed items is combined to arrive at the total NIRF inventory value. The NIRF is the source file for the inventory amounts reported on the DSCP Defense Stock Fund Trial Balance. The Defense Finance and Accounting Service relies on the DSCP Defense Stock Fund Trial Balance to prepare the DLA financial statements. DSCP is responsible for ensuring that inventory amounts provided in the NIRF and the DSCP Defense Stock Fund Trial Balance are complete, accurate, and reliable.

Determining the Acquisition Cost

Inventory prices are calculated within the SAMMS financial subsystem by the Standard Pricing Application (Pricing System). The Pricing System computes an acquisition cost for each item based on obligation history records stored in the standard pricing master file (SPMF) and provides the acquisition cost to inventory files in the other four subsystems. The acquisition cost is used to value on-hand inventories on the financial statements and is updated monthly after any procurement action. Additionally, the Pricing System calculates a standard price for each item and consists of the item's acquisition cost plus a cost recovery factor or surcharge. The standard price is the sales price charged to customers and is updated annually at the beginning of each fiscal year. The DSCP Pricing Activity, operating under the DSCP Office of the Comptroller, is responsible for maintaining accurate and reliable prices. See Appendix B or a detailed description of the acquisition cost calculation process.

Testing Valuation

DLA developed a statistical sampling plan to measure the dollar value accuracy of its inventory amounts reported on the financial statements of the DLA Working Capital Fund. The DLA sampling plan was established to test the existence of the inventory. The plan did not include procedures to validate the inventory pricing data for the items reviewed. To validate the values assigned, we performed pricing reviews during FY 2000 at the managing DLA inventory control points, including DSCP.

Using items selected by the sampling plan, we analyzed the acquisition costs of 728 NSNs that DSCP managed in the general and industrial, clothing and textiles, and medical commodities. The 728 items consisted of 695 items that

were included in a universe of 3,153 items that DLA randomly selected from the on-hand inventory records maintained in the Distribution Standard System at 11 DLA distribution depots. The 728 items reviewed also included a judgmental review of 33 items selected to provide additional coverage of unusually low and high value acquisition costs on the DSCP NIRF. See Appendix A for details on the selection of items reviewed.

Using Available Information for Valuation

DSCP did not always accurately value the non-subsistence inventory items that it managed. DSCP did not accurately value 194 of the 728 non-subsistence items we reviewed using obligation history information with the latest representative purchase price on record. The inaccurate acquisition costs resulted in a $486,336 misstatement of the on-hand inventory values. Table 1 shows the reasons for the inaccurate values.

Table 1. Items With Inaccurate Acquisition Costs

Reason for Inaccurate Acquisition Cost	Number of Items	Financial Inventory $	Misstatement of Inventory $
Government-Furnished Materiel Cost Used	25	$1,141,337	$(249,157)
Direct Vendor Delivery Cost Used	8	429,749	(86,498)
Incorrect Estimations	73	975,658	20,449
FY 1992 Conversion to Latest Acquisition Cost	26	487,235	(254,352)
SAMMS Pricing System Errors	56	6,919,124	83,412
Zero Value Acquisition Costs	6	0	(190)
Total	**194**	**$9,953,103**	**$(486,336)**

The SAMMS Pricing System contains a purchase trailer (the Trailer) section in its SPMF to store current and historical procurement (obligation) records used in the acquisition cost calculation process. Each obligation transaction in the Trailer of the SAMMS Pricing System contains the following data: obligation document number, quantity, purchase cost per unit, total obligation amount, Government-furnished materiel (GFM) unit cost, funds classification code, award date, and modification date. When multiple lines for a given NSN are procured on one contract, all lines are consolidated. The Trailer is capable of storing a maximum of 25 purchase records, including the latest three direct delivery purchase records, for each stocked item. The number of obligation transactions stored on each SPMF record varied according to the age of the transaction and the type of item. If the item is a logistics gain that has not had

any activity, the system should keep transactions that are up to 5 years old. For other items, the system should keep trailers that are up to 3 years old based on the contract modification date provided in the obligation transaction.

Government-Furnished Materiel. For 25 of the 194 items inaccurately priced, the acquisition costs contained erroneous calculations associated with GFM.

In the Trailer of the SAMMS Pricing System, unit costs are allocated between the purchase cost per unit and GFM cost. In addition, the items have a cut, make, and trim cost recorded as part of the purchase cost per unit section. The DSCP clothing and textiles pricing monitor was using two different methodologies to record GFM costs. Using one method, the DSCP contracting officials would enter the GFM costs directly into the SAMMS Pricing System. Using the second method, the contracting officials would provide a letter to the DSCP comptroller identifying the GFM costs that were required to be manually entered into the SAMMS Pricing System.

The GFM cost was not always included in the acquisition cost or the contracting official inaccurately identified the GFM cost. Also, the comptroller section did not maintain a record of the notification letters sent from the clothing and textiles contracting officials. For example, one item in our review was a poly-wool gabardine man's coat (NSN 8405-01-279-6116) that the DSCP clothing and textiles commodity managed. At the time of our review, 188 assets on hand were valued at $89.67 each.

We obtained the originating contract file that identified the acquisition cost of $115.36 that included cut, make, and trim cost of $89.67 and GFM costs of $25.69. Even though a contract identified GFM costs not included in the acquisition cost, the pricing monitor did not provide a letter to update SAMMS records. As a result, the acquisition cost of the item was understated by $25.69, and the total inventory value for the 188 on-hand assets was understated by $4,830.

Cases in which the acquisition cost did not include the GFM cost in the SAMMS Pricing System and contract history file also existed. For example, a women's poly-wool dress coat (NSN 8410-01-413-2814) that the DSCP clothing and textiles commodity managed did not include $12.19 in GFM costs. At the time of our review, 842 assets on hand were valued at $61.95 each. The $61.95 acquisition cost did not include the GFM cost. The exercised contract option price was $76.39 that included a cut, make, and trim cost of $64.20 and GFM cost of $12.19. We also reviewed the contract history file and determined that the acquisition price for GFM listed did not match SAMMS Pricing System and the original contract. As a result, the acquisition cost of the item was understated by $14.44, and the total inventory value for the 842 on-hand assets was understated by $12,158.

Direct Vendor Delivery Costs. Direct Vendor Delivery (DVD) contracts are a method of contracting which features direct delivery from a designated vendor to a customer. The purpose of DVD contracts is to reduce logistics response

time and infrastructure costs. For 8 of the 194 items, DVD contracts were used in the calculation of the acquisition costs, even though the acquisition cost should only calculate the depot replenishment stock deliveries.

The acquisition costs for eight items reviewed included DVD contracts issued for the sole purpose of transporting depot stock from one location to another, and for stock transfers back to the contractor identified as a DSCP depot storage location. To illustrate, one item in our review was a man's lightweight jacket (NSN 8405-01-298-6894) managed under the DSCP clothing and textiles commodity. At the time of our review 3,338 assets were on hand, valued at an acquisition cost of $46.47 each. The last contracted price for the item was $51.27. The SAMMS Pricing System used an average of both depot replenishment stock and DVD contracts. In a period of 6 months, DSCP had awarded 20 DVD contracts to move the stock from one location to another location at $5.87. The average acquisition cost of $46.47 included the DVD contract price of $5.87 and last contract price of $51.27.

According to the DLA Systems Integration Office officials, SAMMS was supposed to contain and use depot replenishment stock contracts in calculations to determine a replacement cost or acquisition cost. According to generally accepted accounting principles, excessive handling should be charged to operations of the period. The inclusion of the DVD contracts in the acquisition cost calculation resulted in a $16,022 understatement for the item's total inventory value. The NSN was just one of 33 NSNs in the family grouping that used the acquisition cost of $46.47 and for which the inventory value for those additional NSNs with assets on hand would be understated.

Also, the acquisition cost in the SAMMS Pricing System represented only the DVD contracts used to transport depot stock from one location to another, instead of the procurement cost. The DVD contracts included stock transfers back to the contractor who identified the contract facility as a DSCP depot storage location. For example, one item was men's trousers (NSN 8405-01-224-3375) that the DSCP clothing and textiles commodity managed. At the time of our review, 108 assets were on hand and valued at $2.45 each. The last depot procurement contract was in August 1997 and identified a cost of $24.40. From October 1998 through October 1999, the only activity was a DVD contract to move stock from one location to another at a cost of $2.45 each.

The SAMMS Pricing System was designed to calculate the acquisition cost using an average of all stock replenishment buys awarded during the last 6 months, plus all other stock replenishment buys that occurred within 45 days of the latest buy. The SAMMS Pricing System should not calculate a new acquisition cost if no stock replenishment buys have occurred in the last six months. By using the DVD contracts, DSCP understated the acquisition cost by $21.95 and the total inventory value for the 108 trousers was understated by $2,371. This NSN, NSN 8405-01-224-3375, was just one of 22 NSNs in the family grouping using the acquisition cost of $2.45. Those additional NSNs with assets on hand would also be understated.

Estimated Acquisition Cost. Of the 194 items incorrectly priced, the acquisition costs for 73 items had been inaccurately estimated. The acquisition costs were identified by an acquisition cost code of "E," indicating that the items were estimated and not calculated by the SAMMS Pricing System based on obligation history records. Documentation was not available to support the methodology used to estimate the acquisition costs, and those costs differed from the latest representative procurement on record.

Obligation History Records in the SAMMS Pricing System. Of the 73 items, 41 had estimated acquisition costs that differed from the most recent procurement prices recorded on obligation history records in the Trailer of the SAMMS Pricing System. One item we reviewed was a control brightness knob assembly (NSN 5355-01-027-1565) managed by the DSCP general and industrial commodity. At the time of our review, 719 assets on hand were valued at an acquisition cost of $312.08 each. However, the last representative buy in the Trailer of the SAMMS Pricing System was for the stock replenishment of 614 items at a purchase cost per unit of $144.40. No data supported the estimated acquisition cost of $312.08 or explained why the last purchase cost per unit of $144.40 was not used. As a result, the acquisition cost of the item was overstated by $167.68, and the total inventory value for the 719 assets was overstated by $120,562.

Obligation History Records in Other SAMMS Files. Of the 73 incorrectly priced items, 7 had estimated acquisition costs that differed from the most recent procurement prices recorded on obligation history records in other SAMMS contract history files. Obligation history records in the Trailer of the SAMMS Pricing System did not support the seven items.

For six of the seven items, DSCP did not use obligation history records provided by the previous DoD inventory manager during the logistics reassignment process to compute the acquisition cost.

In 1990, the Deputy Secretary of Defense approved the transfer of the management of about 1 million consumable items from the Military Departments to DLA. Additionally, as part of the 1995 Defense Base Realignment and Closure decision, DLA realigned more than 600,000 items among its inventory control points. The logistics reassignments occurred between FY 1991 and FY 2000. DLA Manual 4140.2, volume II, part 1, "Defense Logistics Agency Supply Operations Manual," July 1, 1999, provides the policy for pricing items acquired during the logistics reassignment process. Specifically, the policy requires the gaining inventory control point to use contract history data that the losing inventory control point provided during the logistics reassignment process to price the transferred inventory until additional procurement action takes place at the gaining inventory control point.

The obligation history records resided in the SAMMS logistics reassignment data file. The file serves as a repository for supply management and contract history data that the losing DoD inventory manager provided during the logistics reassignment process, but not posted to the SAMMS Pricing System. By not using the appropriate contract history data, DSCP misstated the inventory value

for the affected items by $24,807. For one of the seven items, the obligation history data resided in the contract history data listing section of the SAMMS contracting technical data file that differed from the estimated acquisition costs.

Obligation History Records in Other Contract History Files. Of the 73 incorrectly priced items, 25 items had acquisition costs that differed from the most recent procurement history file that the Information Handling Service's Haystack Windows Online Service maintained (the Haystack) and was readily available to DSCP. For those items, none of the SAMMS contract history files had obligation history records.

The Haystack is an on-line parts research and logistics management system that provides comprehensive information for more than 11 million parts contained in the Federal Supply Catalog and related databases. The Haystack procurement history file contains procurement data obtained on a quarterly basis from the Military Departments and DLA through the Freedom of Information Act.

The obligation history record from the procurement history file contains the contract number, source, date of contract award, unit price, purchased quantity, and total obligation amount. Contract information from the Haystack procurement history database appeared to be reliable. For the 109 items in our review where we were able to obtain the contract files, procurement history reports were available from the Haystack service for 109 of the items. The pricing information from the contract files for 105 of the 109 items matched the pricing information from the Haystack procurement history file.

One item in our review was an identification marker (NSN 7690-01-207-9229) managed by the DSCP general and industrial commodity. At the time of our review, 24 assets valued at $169.90 each were on hand. Our review of the Haystack procurement history file of the item showed an Army contract awarded for 85 items at a cost of $0.30 each. No data supported the estimated acquisition cost of $169.90. As a result, the total inventory value for the 24 assets was overstated by $4,070.

Similar problems may be resident in a material portion of the universe of DSCP-managed items. In addition to the items included in our review, 30 percent of the $2 billion of inventory reported by DSCP on the September 30, 1999, Trial Balance was valued based on estimated acquisition costs. The data were derived from a program developed by the DLA Systems Integration Office as a result of our audit. The programs stratified the number of items and on-hand inventory value in the September 30, 1999, DSCP NIRF by acquisition cost code. On-hand assets of 110,018 items valued at $615 million had an acquisition cost code of "E" (estimated, not calculated, cost code).

Conversion to Latest Acquisition Cost. For 26 of the 194 items with an inaccurate acquisition cost, the acquisition cost was calculated when DLA converted to the latest acquisition cost inventory valuation method in FY 1992. The acquisition costs were identified by an acquisition cost code of "C" in the SAMMS Pricing System, indicating that the acquisition cost was calculated

when DLA converted to the latest acquisition cost inventory valuation method in FY 1992. Before 1992, the inventory maintained in SAMMS was valued at a standard price. The standard price of an item consisted of its acquisition cost plus a cost recovery percentage, or surcharge, and a 3.8 percent inflation factor applied by the managing inventory control point. On July 1, 1992, the DLA Systems Automation Center (renamed the DLA Systems Integration Office in June 1999) completed a major change to SAMMS to value inventory at the latest acquisition cost rather than its standard price. To compute the latest acquisition cost for each NSN, a one-time revision was used that scanned the SPMF and calculated an acquisition cost by removing the surcharge and 3.8 percent inflation factor from the current standard price. The conversion process did not ensure that the newly calculated acquisition cost was supported by the latest stock replenishment obligation.

The conversion process resulted in a misstatement of the inventory value for the 26 affected items. To illustrate, one item in our review was a self-locking nut, plate (NSN 5310-01-207-7376) managed by the DSCP general and industrial commodity. At the time of our review, 166 assets valued at an acquisition cost of $12.64 each were on hand. The Haystack procurement history report for the item showed one Army contract was awarded for $0.85 each. Documentation was not available to support the acquisition cost of $12.64. We concluded that the acquisition cost of the item was overstated by $11.79, and the total inventory value for the 166 on-hand assets was overstated by $1,957.

SAMMS Pricing System Computations. For 56 of the 194 items incorrectly priced, the SAMMS Pricing System computed the acquisition costs based on obligation history records. The items were identified with an acquisition cost code of "A," indicating that the acquisition cost was computer generated based on DLA-awarded contracts or obligation data provided by the previous inventory manager if the item was a logistics gain. However, flaws in the computation process resulted in a misstatement in the inventory value for the items.

Accuracy of the Family Group Acquisition Costs. For 45 of the incorrectly priced 56 items, obligation history data resided in the contract history buy data listing section of the SAMMS contracting technical data file that differed from the acquisition cost. For the clothing and textiles commodity, DSCP has combined similar NSNs into family groups and all transactions in the SAMMS Pricing System are completed within a family group including the acquisition cost analysis.

As an example of family groupings, the temperate woodland camouflage coat, Type 1, has 22 different sizes that range from the extra small, to medium-regular, up to large-extra large. The family group updated its acquisition cost when one or more NSN had obligation activity. Even though each size is identified by an individual NSN in SAMMS, the Pricing System updates the acquisition cost of each NSN within the family group whether or not a new obligation occurred for an individual NSN. In contrast when placing the contract delivery orders, the individual NSNs and quantities, not the family groups, are identified to ensure the correct size and quantity are ordered and

received. The SAMMS Pricing System does not determine if the individual NSNs within the family have had any obligation activity that justifies an acquisition cost change. The contracting technical data file is an automated database file that supports the procurement of items by DLA, and the contract history field should be updated automatically when a transaction is posted to the SAMMS active contract file by the DSCP contracting organization. However, none of the 45 items was supported by

obligations in the Trailer of the SAMMS Pricing System. By not using the appropriate contract history data, DSCP misstated the inventory value for the affected items by $38,418.

Other Inaccurate System-Calculated Acquisition Costs. Of the 56 incorrectly priced items, 11 items that had inaccurate acquisition costs were generated by the SAMMS Pricing System for a variety of other reasons. Reasons included nonrepresentative obligation history records being used in the acquisition cost calculation, representative obligation history records being left out of the acquisition costs calculation, canceled contracts, and various other minor errors.

For canceled contracts, a programming error existed in SAMMS. The Pricing System did not recalculate the acquisition cost using the second most recent stock replenishment obligation when the most recent obligation was canceled. We discussed the issue with the DLA Systems Integration Office and were informed that the programming did not allow for the acquisition cost to be recalculated when a contract was canceled. The computer specialist responsible for maintaining the SAMMS Pricing System corrected the programming as part of an April 2000 systems change. However, the change was not retroactive. Therefore, the Pricing Activity at each DLA inventory contract point would have to identify and correct any existing acquisition costs that were based on canceled contracts.

Items with No Acquisition Cost. For 6 of the 194 items that were incorrectly priced, no acquisition cost existed even though NIRF contained on-hand assets. The items were identified as NSNs that were non-stock purchases (acquisition cost code number 2). The acquisition cost was missing because no procedures were in place to ensure that all NSNs with on-hand inventory were assigned an acquisition cost. The lack of an acquisition cost resulted in an understatement of the inventory value for the affected items.

For example, helmet pads (NSN 8415-01-422-2249) managed by the DSCP clothing and textiles commodity were identified as a local purchase NSN. However, DSCP was reporting 149 items on-hand at $0.00. We discussed the issue with the DLA Systems Integration Office personnel who told us that SAMMS had processes to ensure that all stocked items contained an acquisition cost in both the SPMF and the NIRF. However, items that were not coded as stocked (identified by a supply status code of 2) were exempt from the process because they generally did not have on-hand assets. As a result of the audit, the DLA Systems Integration Office developed a program that would identify the unusually low and high acquisition costs in the SAMMS NIRF and write them to a file. Items with unusually low acquisition costs included those with a zero

value. The program was established as a permanent program that could be executed upon request. The DSCP Pricing Activity should use the program the DLA Systems Integration Office developed to identify all zero value acquisition costs at the end of each reporting period and ensure they receive a reasonable price.

Quality Assurance Program for Inventory Prices. DSCP did not previously detect the inaccurate acquisition costs we identified because it had not established a quality assurance program to ensure the accuracy of inventory prices. With 7 pricing analysts responsible for maintaining accurate prices for more than 1.8 million items, efforts were focused on ensuring the accuracy of prices recommended by the SAMMS Pricing System for fast-moving (active) items before release. However, many of the items that we found with inaccurate acquisition costs had little sales and procurement activity (were inactive) and were not reviewed by pricing analysts. Some of the inaccurate acquisition costs we identified have resided in SAMMS since FY 1992. To ensure continued accuracy of all its prices, DSCP must establish a quality assurance program for inventory prices. As part of that program, the DSCP Pricing Activity should perform scheduled reviews on inactive items using the procedures described in DLA Manual 7000.2, Volume II, part 1, "Standard Automated Material Management Systems (SAMMS) – Financial Subsystem Operating Procedures," July 1999, as well as test the accuracy of prices for active items.

Availability of Obligation History Records

For 28 items valued at about $2.9 million (see Table 2), the SAMMS Pricing System did not have obligation history records to support the acquisition costs because the obligation history records were purged from the contract history files. Additionally, none of the other contract history files (contracting technical data file, logistics reassignment data file, or Haystack procurement history database) had obligation history records to support the acquisition costs. Without supporting obligation history records, we were unable to determine the accuracy of the assigned acquisition costs.

Table 2. Items Without Supporting Obligation History Records

Type of Item	Number of Items	Financial Inventory $
Logistics Gain Items	18	$ 151,179
Other Items	10	2,745,941
Total	**28**	**$2,897,120**

For an item acquired by DSCP through the logistics reassignment process, a purchase record resulting from a DSCP procurement is established and updated by obligation transactions received from the SAMMS distribution subsystem if the transaction is a result of contract history data provided by another DoD inventory control point (a logistics gain).

Logistics Gain Items. Of the 28 unsupported items, DSCP acquired 18 items during the logistics reassignment process. We researched the SAMMS logistics reassignment data files for those items and determined that the obligation history data were not obtained during the logistics reassignment process.

For logistics gain items for which the obligation records were not obtained, the SAMMS Pricing System is programmed to set the acquisition cost equal to the standard price of the DoD inventory control point that previously managed the item provided. The standard price should represent the cost incurred by the previous DoD inventory manager to acquire the item plus the applicable cost recovery factor or surcharge. Using the standard price to value on-hand inventory resulted in an overstatement of the financial inventory value.

Other Items. Of the 28 unsupported items, 10 items were not supported by obligation history records and were not identified as logistics gains. For these items, the obligation history data was purged from the Trailer of the SAMMS Pricing System. We researched additional automated sources of contract data, but the other sources of contract data were unable to provide support for the assigned acquisition costs.

Availability of Contract Files

For 377 items valued at approximately $14 million (see Table 3), obligation history records existed in the Trailer data of the Pricing System or other obligation history databases to support the acquisition cost, but the originating contract file was not available to support the limited information provided on the obligation history record. The supporting contract files were not available because the files were destroyed when their age exceeded DLA contract file retention requirement, or were not obtained during the logistics reassignment process, were lost, or were associated with deployable medical systems with no supporting pricing documentation.

Table 3. Items Without Supporting Contract Files		
Reason For Missing Contract File	Number of Items	Financial Inventory $
Age Exceeded DLA Retention Requirements	174	$ 3,477,348
Not Obtained During Logistics Reassignment Process	33	278,512
Lost	155	965,654
Deployable Medical Systems	15	9,214,877
Total	**377**	**$13,936,391**

DLA Contract File Retention Requirements. The DLA policy for retaining contract files is established in DLA Instruction 5015.1, "DLA Records Management Procedures and Records Schedule," March 1, 2000. DLA policy defines contracts as individual and subcontract case files accumulated from the administration of individual contracts consisting of purchase orders, contracts, comparable instruments, and other documentation, as applicable, as required by the Federal Acquisition Regulation. According to DLA policy, contracts for more than $25,000 are to be retained for 6 years and 3 months after final payment. Contracts for $25,000 or less are to be retained for 3 years after final payment. The retention criteria are based on the time frames established in the Defense Federal Acquisition Regulation Supplement.

DSCP Contract Retention Procedures. DSCP did not have local procedures specifying the time period for retaining contract files. The DSCP officials relied on DLA policy and the Defense Federal Acquisition Regulation Supplement. The DSCP officials also stated that contract files more than 6 years old were generally destroyed unless specific justification was provided for their retention.

Obligation Records Exceeding DLA Contract Retention Periods. A total of 174 of the 377 items had an obligation history record in the Trailer of the SAMMS Pricing System but the actual contract files were unavailable because it exceeded DLA contract retention requirements. The lack of contract files prohibited us from determining whether the acquisition costs were based on representative stock replenishment buys and void of abnormal costs such as excessive handling or rework costs. Additionally the age of the most recent obligation history records supporting the acquisition costs raised concerns about the future utility (likelihood of sales) of the on-hand inventory.

Obligation Records for Logistics Gain Items. A total of 33 of the 377 items had an obligation history record in the Trailer of the SAMMS Pricing System but the actual contract file was unavailable because it was not obtained by DSCP during the logistics reassignment process. The items were identified by a type of price change code of "L" to show that the obligation records electronically provided by the previous manager were used in the acquisition cost calculation. We could not be reasonably assured that the obligation records were reliable without reviewing the actual contract files.

Obligation Records Within the Federal Contract Retention Period. A total of 155 of the 377 items had an obligation history record in the Trailer of the SAMMS Pricing System but the actual contract files were not available for review even though their contract modification dates fell within the DLA contract retention requirements.

Importance of Originating Contract Files. Without being able to review the originating contract files, we could not be reasonably assured that the limited data provided on the obligation records were complete and accurate. For example, one item in our review was Women's slacks (NSN 8410-01-442-7332) which the DSCP clothing and textiles commodity managed. At the time of our review, 906 assets were on hand, valued at an acquisition cost of $12.37 each. We obtained the originating contract file that identified an acquisition cost of $21.58 and included cut, make, and trim cost of $9.57 and GFM costs of $12.01. Because the acquisition cost was not representative of cut, trim, and make and GFM costs, the on-hand inventory value was understated by $8,344.26. Without reviewing the actual contract file, we would not have been able to determine that obligation records in the Trailer of the SAMMS Pricing System did not support a representative stock replenishment buys.

Obligation Records for DEPMED Items. A total of 15 of the 377 items were Deployable Medical Systems (DEPMEDS) stock valued at $9.2 million. DEPMEDs are standardized modular field hospitals that can be pre-positioned in the event of a contingency, national emergency, or war operations. DEPMEDs use shipping containers for self-contained hospital facilities such as pharmacies, radiology laboratories, and surgery clinics. The products are purchased under individual NSNs and assembled into a DEPMEDS NSN. The SAMMS Pricing System automatically prices the DEPMEDS at a standard price and publishes the standard price annually in the DEPMEDS End Item Standard Pricing Report. The acquisition cost is calculated by removing the surcharge from the prevailing standard price.

For the DEPMEDs reviewed, the acquisition cost reported in SAMMS did not equal the standard price less the surcharge. The acquisition costs for the 15 items were understated by $1.4 million.

DSCP did not maintain any supporting pricing documentation from the original completion of the DEPMEDS. Each year, SAMMS calculates the standard price for DEPMEDS based on the market value of each individual component of a DEPMED. The acquisition cost for the DEPMEDS is adjusted annually to reflect the change in the market value identified in the standard price calculation. DSCP Pricing Activity had not reviewed the DEPMEDS SAMMS acquisition cost or standard price with the contracting files because the contract files were unavailable to validate the SAMMS acquisition cost.

Potential for Additional Acquisition Cost Inaccuracies

During the audit, we identified 73 items that had acquisition costs inaccurately estimated (identified by an acquisition cost code of "E"). Additionally, 27 items had acquisition costs that were inaccurately computed during the initial acquisition cost conversion in FY 1992 (identified by an acquisition cost code of "C"). Of the 199 items with inaccurate acquisition codes, a total of 100 items were identified with the inaccurate acquisition costs codes of "C" and "E." Table 4 shows "C" and "E" items in the universe.

Table 4. September 30, 2000, DSCP Inventory by Acquisition Cost Code

Acquisition Cost Code	NSNs with On-hand Assets	Percent of Total NSNs	Total On-Hand Inventory Value	Percent of Total Value
A	233,927	49.9	$1,162,431,334.82	63.55
C	134,331	28.6	117,623,767.95	6.43
E	101,059	21.5	547,936,110.33	29.95
Other	418	0.0	1,303,578.36	.07
Total	**469,735**	**100.0**	**$1,829,294,791.46**	**100%**

We believe the potential for the problems identified during the audit exists in a material amount in the universe of DSCP inventory. A significant number of items in the FY 2000 DSCP NIRF were coded as having been computed in the same manner as those found inaccurate by our audit. In Table 4,[2] 235,390 NSNs with on-hand assets existed that had acquisition costs identified by acquisition cost codes "C" and "E," which represented 50 percent of the 469,735 DSCP-managed items with on-hand inventory. Additionally, the $665.6 million on-hand inventory value for those items represented more than 36 percent of the total $1.8 billion DSCP inventory value as of September 30, 2000. See Appendix C for the break down of the inventory by acquisition cost code by the three DSCP commodities.

Summary

The 728 items we reviewed represented only a small portion of the total DSCP inventory because the items were selected as part of an effort to measure the accuracy of all DLA-owned inventories. However, we believe that items having acquisition costs developed in the same manner as those found to be inaccurate by our review exist in a material amount in the total universe of DSCP inventory. Additionally, the system changes implemented by the DLA Systems Integration Office were not retroactive, and we do not know how many

[2] Appendix C contains the detailed break down of the general and industrial, clothing and textile, and medical commodities for September 30, 2000.

additional items exist in the universe of DSCP inventory that were valued using the inaccurate methods identified. DSCP needs to review the NIRF, and identify and correct any additional inaccurate acquisition costs.

We also believe that additional inventory valuation problems may have gone undetected because DSCP had not established a quality assurance program to ensure the accuracy of its inventory prices. Further, we could not determine the reasonableness of the acquisition costs used to value on-hand inventories for items without supporting obligation history records. A significant number of items were valued using acquisition costs that could not be supported by an obligation history record in the SAMMS Pricing System or other automated contact history files. In the absence of procurement histories, DoD Regulation 7000.14-R, Department of Defense Financial Management Regulation, Volume II B, "Reimbursable Operations, Policy, and Procedures for the Defense Business Operations Funds," December 1994, permits DoD activities to estimate acquisition costs based upon current manufacturer parts listings or market price quotations. DSCP must identify all items that are not supported by obligation history records and estimate a reasonable price using DoD guidance.

Additionally, we could not be reasonably assured that the acquisition costs used to value on-hand inventories were based on the latest representative stock replenishment buy and were void of any abnormal costs without being able to review the supporting contract files. Contract files will not be available to support the significant number of items that had acquisition costs based on obligation history records that were more than 6 years old or that were provided electronically by the Military Departments during the logistics reassignment process. In the absence of the originating contract data, DSCP must disclose the value of the on-hand inventory that cannot be properly supported, and the disclosures must continually be made until the amount of inventory valued based on unsupported acquisition costs is reduced to an immaterial amount. Also, because on-hand inventory is frequently retained longer than the maximum 6-year time period required for retaining the contract files that support the last purchase price, DSCP must establish that the obligation history records in the SAMMS Pricing System are reliable and contain accurate information based on the originating contract files. Until all of those actions are accomplished, we cannot be reasonably assured that financial inventory values that DSCP reported are free from material misstatement.

While our review showed that 82.3 percent of the items reviewed at the Defense Supply Center Philadelphia were not accurately computed or were not supported, similar rates of discrepancy were found in items reviewed at the Defense Supply Centers in Columbus and Richmond. The results of all three Centers will be reported in a summary report.

Management Comments on the Finding and Audit Response

Management Comments. DLA partially concurred with the finding, but stated that the DLA procedure is to compute the latest representative acquisition cost using the weighted-average acquisition cost of stocked items using the latest

contract and any other buys made in the preceding 44 days. DLA concurred that the audit identified areas where DLA could improve policies and procedures

Audit Response. We accepted the DLA averaging methodology as accurate during the audit. However, acquisition costs we identified as inaccurate differed significantly from the most recent representative purchase price, including the average of the most recent purchase price and all buys made in the preceding 44 days.

Management Comments. DLA stated that the error rate cited in the draft finding was incorrect. Specifically, DLA disagreed with the 377 items without supporting contracts. DLA stated that it had retained contracts for the required retention period. DLA also implied that current electronic files are the basis for obligations and disbursements and that it did not receive paper contract copies. Furthermore, DLA stated that the vendors are paid the true cost based on an active contract file from the Defense Finance and Accounting System and reasoned that the active contract file could have been used to audit pricing. Finally, DLA identified that standard prices for the DEPMEDS are established at the assembly level by a special program but the program does not capture the acquisition cost at assembly level. To capture the acquisition cost, SAMMS would have to be reprogrammed and there is a moratorium on system changes to SAMMS.

Audit Response. We were unable to rely on the inventory valuation dates in SAMMS because DLA could not provide assurance that the data were complete, accurate, and reliable. We included the 377 items because supporting contract files were not available for us to review, and we could not make a determination about the reasonableness of the acquisition cost. For the 174 items with contracts that exceeded the age retention requirements, 33 logistics reassignment items were without supporting contract files. Because source documents for the acquisition costs used were not available, DLA needs to disclose the total inventory value for items in those two categories. In addition, 155 of the 377 items were within the legal contract retention requirement. Although DSCP had converted to electronic files, the electronic copy of the contract was not available. Without the supporting documentation, the accuracy of the acquisition cost for those items could not be determined. In performing this audit we used the DLA policy for verifying the latest acquisition cost. The remaining 15 items were related to the DEPMEDS. Although there is a moratorium for systems changes in SAMMS, DLA needed to ensure that the acquisition costs are captured when SAMMS is replaced the DLA Business System Modernization.

Management Comments. DLA stated that its methodology was revised in FY 1992 that removed 8.1 percent of the price as a proxy for the average surcharge included in the standard price inherited from the Services.

Audit Response. For items gained from the Military Department, we disagree that the 8.1 percent was representative of the average surcharge. The surcharges for the Military Departments in FY 1995 ranged from 23.8 percent to 52.1 percent and in FY 2000 the range was from 13.4 percent to 44.6

percent. Without supporting documentation, DLA needs to require that the acquisition costs for those items be estimated based upon current manufacturer price listings or market price quotations.

Recommendations, Management Comments, and Audit Responses

A. We recommend that the Commander, Defense Supply Center Philadelphia:

1. Develop and implement procedures in the Standard Automated Materiel Management System to accurately compute acquisition costs used to value on-hand non-subsistence inventories based on the latest representative purchase price. The procedures should require the Defense Supply Center Philadelphia Pricing Activity to:

a. Fully document and maintain the methodology used to estimate acquisition costs and use the latest representative purchase price as a basis.

Management Comments. DLA partially concurred and stated that it uses the weighted-average methodology to compute costs from recent representative contract prices. DLA planned to review DLA Manual 7000.2 and ensure that the DLA inventory valuation methodology is fully documented by July 2001.

Audit Response. The DLA comments were partially responsive to the recommendation. The comments did not specifically address the acquisition costs that are estimated. DLA corrective actions should specifically include procedures to document the supporting data for acquisition costs that are estimated.

b. Use consistent acquisition cost data in the national inventory record file and the standard pricing master file.

Management Comments. DLA concurred with the recommendation, stating that this is DLA practice. DLA does acknowledge instances when an update to the standard pricing master file has not been recorded in national inventory record file. DLA identified that at the end of each month, SAMMS reconciles the standard pricing master file with the national inventory record file and creates a report of change.

c. Use the program developed by the Defense Logistics Agency Systems Integration Office to identify and correct all acquisition costs with a zero value at the end of the each reporting period.

Management Comments. DLA concurred with the recommendation, stating that the program is in place at DSCP.

Audit Response. Although DLA concurred with the recommendation, it did not provide the effective date of the program. At the time of the audit, the DLA

Systems Integration Office program was not being used at DSCP. Additionally, DLA previously responded to similar recommendations we made to the inventory control points in Columbus, Ohio, and Richmond, Virginia, and stated that a review would be conducted and recommendations would be made to the Business Systems Modernization office at DLA. We request DLA to provide the implementation date of the program at DSCP to the final report.

d. Identify and correct all acquisition costs residing in the national inventory record file that were using computed data based on inaccurate methods identified by this audit, including acquisition costs incorrectly estimated, acquisition costs incorrectly computed during the FY 1992 conversion to the latest acquisition cost inventory valuation method, and acquisition costs erroneously based on canceled contracts.

Management Comments. DLA partially concurred with the recommendation, and stated that its pricing methodology, averaging the most recent contracts to compute prices, results in more accurate pricing. DLA will review the current DOD inventory valuation policies to ensure compliance of DLA policies and procedures, especially concerning the appropriateness of eliminating acquisition costs erroneously based on cancelled contracts. Estimated completion data for this action is September 28, 2001.

2. Establish a quality assurance program to ensure the accuracy of non-subsistence inventory prices. The program must include procedures to test the accuracy of prices for all items, including inactive items.

Management Comments. DLA concurred with the recommendation and stated that the Defense Supply Center Columbus will develop a sampling plan to test the accuracy of inventory prices. DLA will coordinate with the other Supply Centers, to include Philadelphia, to see if a sampling program is already being utilized. Upon completion, the sampling program will be disseminated to the other Centers for use as appropriate. The estimated completion data for these actions is September 28, 2001.

3. Develop and implement procedures to identify the total non-subsistence inventory value for items with acquisition costs not supported by obligation history records and require that the acquisition costs for those items be estimated based upon current manufacturer's price listings or market price quotations. Additionally, develop and implement procedures to disclose the total inventory value for items with acquisition costs based on obligation history records provided by the previous managing inventory control point for logistic gain items and acquisition costs based on Defense Supply Center Philadelphia obligation history records more than 6 years old.

Management Comments. DLA partially concurred with the recommendation, stating that they agree in principle with the recommendation, but because it will require an intensive manual effort, they will assess the costs and benefits of any changes to procedures prior to any implementation. DLA stated that the analysis would be completed by July 31, 2001.

4. Develop and implement procedures to retain the latest representative obligation history record in the purchase trailer of the standard pricing master file and require the retention of supporting contract files in accordance with Defense Logistics Agency retention requirements.

Management Comments. DLA partially concurred with the recommendation, stating that contracts are retained in accordance with Federal Acquisition Regulation requirements and that retention beyond those time frames for items that have not been procured beyond this period would have a far reaching impact not only to DLA but the Military Services. Additionally, the Military Services would also be required to retain and pass the records to the DLA upon Logistics reassignments. DLA stated that the recommendation should be addressed to the Under Secretary of Defense (Comptroller) for review and comment.

Audit Response. Although DLA partially concurred with the recommendation, we do not consider its comments responsive. Our recommendation does not require that contract files be retained beyond Federal Acquisition Regulation guidelines and it does not apply to the Military Departments. We found that the SAMMS Pricing System did not always retain the latest representative obligation history records. We believe that DLA needs to address the retention limitations of obligation history records in the SAMMS Pricing System. Additionally, DLA needs to issue procedures to its inventory control points specifying the Federal Acquisition Regulation requirements and ensure that these procedures are incorporated into any automated contract folder initiatives. Those actions are the responsibility of DLA, not the Under Secretary of Defense (Comptroller). We request DLA provide comments to the final report.

B. Inventory Valuation of Defense Supply Center Philadelphia Subsistence Items

The DSCP assertion that inventory valuation was accurate and supported by contract data was not reliable for the subsistence commodity.

- Of the 81 items selected for review (valued at $204 million), 49 items (valued at $192 million) were not accurately computed based on the latest representative obligations or fully supported by the originating contract files.

- The trial balance did not have adequate support.

The conditions occurred because procedures were not in place to compute acquisition costs based on the latest purchase cost information, disclose unsupported cost data that were used, and retain supporting contract data. Additionally, DSCP had not established a quality assurance program for inventory prices. As a result, the subsistence inventory was overstated by $1.8 million.[3] Until the deficiencies leading to the inaccurate and unsupported acquisition costs are corrected and fully disclosed, DSCP inventory valuation data cannot be relied upon to support the $220 million subsistence amount reported on the DLA financial statements.

Sample of Subsistence Inventory Items

DLA did not include the universe of items from the subsistence commodity when developing its random sampling plan for testing the existence of inventory under the Chief Financial Officers Act. As a result, we used a judgement sample to select and analyze the acquisition costs for the subsistence items at DSCP. We selected 81 NSNs, valued at $204.9 million, from the subsistence commodity that DSCP managed. See Appendix A for details on the reviewed 81 items selected.

Unlike the SAMMS system used by DSCP to manage non-subsistence items, DSCP uses the Defense Integrated Subsistence Management System (DISMS) to manage the subsistence commodity. DLA Instruction 5015.1 states that DISMS is a materiel management system that provides information about supply, contracting, warehousing, and transportation functions.

We compared the available DISMS acquisition costs available to the information in the associated contracts. We also tested whether the acquisition costs used to

[3] In our evaluation of a meal ready-to-eat item (NSN 8970-00-149-1094), we incorrectly excluded a $4.4 million overstatement. As result, the understatement of $2.6 million for Subsistence in the draft report has been changed to a $1.8 million overstatement.

value the 81 items in the DSCP financial reports were accurately computed and supported by obligation history records in the DISMS. We then tested whether the obligation records could be verified to the originating contract files. We performed these tests to verify whether the acquisition costs were based on the latest acquisition cost inventory valuation method as required by Federal accounting policy.

Results of Sample

DSCP did not use available obligation history data or the latest representative purchase price on record to value 49 items of the 81 items reviewed. The use of inaccurate acquisition costs resulted in a $1.8 million overstatement of the on-hand inventories valued at $192 million. Our analysis of the acquisition costs reflected the following errors.

DISMS Pricing System Computations. Of the 49 items, 7 items (valued at $6 million) were incorrectly priced. The DISMS Pricing System computed the acquisition costs based on obligation history records. Errors in the computation process resulted in a misstatement in the inventory value for the affected items. For example, one of the items in our review was ground black pepper (NSN 8950-00-127-8067) that the DSCP subsistence commodity managed. At the time of our review, 60,932 cans were on hand. DISMS Pricing System showed an acquisition cost of $1.76. However, the last contract award price was $2.90. The DSCP Pricing Activity could not explain why the price was understated by $1.14 each. The inaccurate acquisition cost caused the financial statement inventory value for the item to be understated by $69,462.48.

Obligation History Records in Other DISMS files. Of the 49 items incorrectly priced, 11 items (valued at $3 million) had acquisition costs that differed from the most recent procurement price recorded on the obligation history records in other DISMS contract history files. The obligation history data of the 11 items resided in the contract history buy data listing section of the DISMS contracting technical data file because obligation history records identified no contract history trailer. By not using the appropriate contract history data, DSCP misstated the inventory value for the affected items. For example, one item in our review was canned beef chunks (NSN 8905-01-243-0099) that the DSCP subsistence commodity managed. At the time of our review, 111,290 assets were on hand. The DISMS Pricing System showed an acquisition cost of $4.14. The DSCP Pricing Activity identified a January 1995 contract to support the acquisition. DSCP could not provide the identified contract. Our review of the contract history buy data listing section of the DISMS contracting technical data file showed that the most recent DSCP subsistence contract was for 240 items at an acquisition cost of $2.21 each. By not using the last contract price for the item, DSCP overstated the acquisition cost for the item by $1.93 and overstated the total inventory value of the 111,290 items by $682,425.30.

Ration and Meal Ready-to-Eat NSNs Calculations. Rations are breakfast, lunch, or dinner menus that are designed to provide good quality, nutritionally

adequate, hot or cold entrées for an individual soldier or group of soldiers under modern battlefield conditions. A ration entrée could include subsistence items that are perishable/frozen, semi-perishable, dehydrated, or canned, and all capable of maintaining a shelf life. For the ration NSNs, DISMS did not automatically calculate the acquisition cost. Instead, the calculations were manually performed by the subsistence Pricing Activity and entered into DISMS. A ration is comprised of numerous individual NSNs. The ration NSN acquisition costs are computed by using the quantity required by an individual NSN multiplied by the current acquisition cost under the Quarterly Variance Report. The pricing monitor obtained the contract history, the quantity ordered, and the purchase price for each NSN within the ration NSN.

No requirement existed to compare the contract history information with the Quarterly Variance Report and to calculate the acquisition cost using on-hand quantities currently in the inventory. As a result, the subsistence Pricing Activity would use the acquisition cost from the Quarterly Variance Report for each individual NSN within the ration NSN. The sum of the total NSNs became the next fiscal year's acquisition cost.

Of the 49 items we reviewed, 31 items valued at $183 million were manually calculated and had unsupported acquisition costs. The DISMS was not programmed to calculate the acquisition cost or annual standard price for the meal ready-to-eat and ration NSNs. The calculations are manually computed and entered annually into the system. The manual calculations for the FY 2000 acquisition costs were unsupported. The supporting documentation had been destroyed prior to a relocation move of the organization during July 1999. However, a reconstructed computation for meal ready-to-eat and ration NSNs was provided.

The reconstructed report identified the ration NSNs, individual NSNs within the ration NSNs, the quantity required per NSN, the standard price, the acquisition price (arrived at as the standard price less the surcharge), the average contracted price, and the difference in the acquisition price and contract number. For the reconstructed data, the subsistence Pricing Activity compared the acquisition cost used with a contract that was representative of the quantity required in the ration NSN. Our analysis identified that the last contracted price was not used. For example, one item in our review, heat and serve breakfast menu 4 (NSN 8970-01-433-0565), had 2,661 assets on hand with an acquisition cost of $183.12 each. The DSCP manual calculation of the acquisition cost by a DSCP official identified a value of $213.68 each. As a result, the acquisition cost of the item was understated by $30.56, and the total inventory value for the 2,661 on-hand assets was understated by $81,320.16.

Additionally, our analysis identified that different acquisition costs were used for the same NSN found in both the ration items and the individual subsistence items reviewed. For example, in our review ration NSN 8970-01-325-1192 contained an individual NSN reviewed during the audit (NSN 8940-00151-6462). Under the ration NSN, the acquisition price used for the individual NSN was $15.86 supported by a 1997 contract. However, the individual NSN Active Contract History report identified contract activity during the FY 1998 with an

acquisition cost of $6.32. Additionally, the standard price, $21.17, was based on the 1997 contract. Finally, DSCP officials could not provide the contracts for either the 1997 or 1998 buys to support the acquisition costs identified. The pricing monitor could not explain why there would be a difference except that the 1998 contract was possibly not representative of the individual NSN.

Unlike the rations, the meal ready-to-eat NSNs used a weighted-average method for determining historical cost value of on-hand inventory. However, the weighted-average did not match the acquisition cost shown in DISMS.

Financial Reporting

DSCP could not provide a sufficient audit trail to support its financial inventory values. DLA reported in the September 1999 Defense Stock Fund Trial Balance $217.6 million in subsistence inventory. However, DSCP reported total subsistence inventory of approximately $220 million on their September 30, 1999, trial balance. The DISMS National Inventory Dollar Value report is used by DSCP to report the subsistence inventory in the trial balance. However, the inventory totals for all storage sites were not reconcilable to the amounts reported on the trail balance, and the report contained $16.5 million of unsupported manual adjustments. These inventory amounts actually reflected the inventory balances at the end of July 1999, even though the year-end values were available in the first week of October. Further, DISMS generates an Inventory Latest Acquisition Cost Changes report that reflects the total subsistence inventory managed by DSCP. The total inventory amount at year-end 1999 was $245 million. That total exceeded the amount reported on the DSCP trial balance by $25 million and the DLA trial balance by $27.4 million. Without adequate procedures in place to report subsistence inventory, we cannot be reasonably assured that the correct data is submitted for inclusion in the DLA financial statements.

Adjustments to Historical Costs. The Subsistence Pricing Activity was not aware of adjustments being made at the end of the fiscal year to adjust on-hand inventory to its historical cost. A DSCP official stated that if DISMS makes a gain or loss adjustment on a monthly, quarterly, or annual basis, DISMS would reflect the quarterly change in acquisition cost. A DSCP official also stated that no review of the adjustment was being accomplished in the Subsistence Comptroller Section. The pricing monitor stated that manual calculations reflect the latest acquisition cost for each meal ready-to-eat and ration NSN. Therefore, there would be no requirement to adjust the latest acquisition cost to a historical cost. The Pricing Activity did not inquire to determine if DISMS was programmed to make adjustments during the year or at the end of the fiscal year.

Summary

The 81 items we reviewed represented a small portion of the total DSCP subsistence inventory. We believe that items having acquisition costs developed

in the same manner as those found to be inaccurate by our review could exist in a material amount in the total universe of DSCP subsistence inventory. DSCP needs to review the subsistence NSNs, and identify and correct any additional inaccurate acquisition costs. We could not be reasonably assured that the acquisition costs used to value on-hand inventories were based on the latest representative stock replenishment buy and were void of any abnormal costs without being able to review the supporting contract files. In the absence of the originating contract data, DSCP must disclose the value of the on-hand inventory

that cannot be properly supported, and the disclosures must continually be made until the amount of the inventory value based on unsupported acquisition costs is reduced to an immaterial amount.

A significant problem existed in obtaining contracting data to support the manual calculation of acquisition cost for ration NSNs. An audit trail did not exist for the manually computed acquisition costs. DSCP personnel reconstructed the data but the analysis showed significant problems when the acquisition costs and the identified contract data were compared. In the end, the validity of the number reported to support the inventory value on the financial statements was questionable.

Additionally, we found that the trial balance was unsupported. We could not determine the inventory universe, the quantity on hand, and the acquisition price used in the calculation of the trial balance. We also could not determine the difference between DSCP and DLA trial balance amounts. Until all of those actions are accomplished, we cannot be reasonably assured that financial inventory values DSCP reported for the subsistence commodity are free from material misstatements.

Management Comments on the Valuation of Subsistence Items

Management Comments. DLA partially concurred with the finding, but stated that less than 20 percent of the subsistence-managed items are at standard price. DLA stated that the prices for produce and food service items provided by the Prime Vendor are updated weekly. Additionally, those items valued at standard price are primarily operational rations and are manually priced on an annual basis. DLA stated that the items included in this inventory sample were those remaining in their supply system but have since been depleted.

Audit Response. The inventory sample used in the audit was a random sample based on inventory levels for the fiscal year end 1999 provided by DLA. Although some of the inventory has been depleted, the audit focused on the accuracy of data in DISMS. The audit results showed numerous inaccuracies with the data in DISMS and this affected the accuracy of the information being reported in the DLA financial statements.

Management Comments. DLA stated that the DLA procedures are to compute the latest representative acquisition cost using the weighted-average of stocked

items based on the latest contract and any other buys made in the preceding 44 days. DLA concurred that the audit has identified areas where DLA could improve policies and procedures.

Audit Response. We accepted the DLA averaging methodology as accurate. However, the acquisition costs we identified as inaccurate differed significantly from the most recent representative purchase price, including the average of the most recent purchase price and any other buys made in the preceding 44 days.

DLA stated that its acquisition cost was based on the latest representative acquisition cost using the weighted average that was based on the latest contract and any other buys made in the preceding 44 days. The acquisition costs we identified as inaccurate differed significantly from the latest representative purchase price and the DISMS acquisition cost. In DISMS, for individual NSN items, the acquisition cost was based on the previous 3 months (quarter of the fiscal year) purchases and averaged to identify a new acquisition cost.

Management Comments. DLA took exception to the black pepper example, NSN 8950-00127-8067, and stated that the $1.76 price was based on a large quantity buy in the early 1990s. DLA stated that the last contracted price of $2.90 was not representative of the 60,932 inventory quantity on hand. DLA stated that the subsistence was actively reducing this time from the inventory, because of a shift to commercial practices and depletion of that item's inventory.

Audit Response. DLA did not have support for the $1.76 acquisition cost for the black pepper. The contract history file identified 22 contracts awarded since 1995. The audit identified the latest acquisition cost was $2.90 per can. Seven months before the latest acquisition cost, a contract for 17,280 cans, approximately one-third of the on-hand inventory, had an acquisition cost of $2.82. Additionally, if a weighted average methodology was used for the 60,932 cans on hand, the acquisition cost would have been $2.12 per can. Also, a 1995 contract for 233,280 cans had an acquisition cost of $1.63 per can. In all four of those cases, the DISMS acquisition cost of $1.76 per can was not validated.

According to DLA policy, the latest representative buy is based on the stock replenishment obligations dated within the past 6 months, and stock replenishment obligations with quantities greater than a one-month's demand dated within 45 days of the latest eligible obligation. The DSCP pricing analyst was not basing the latest representative buys on monthly demand, but on "significant quantities" of past contracts. As a result, DLA needs to ensure policies and procedures explicitly define the criteria for determining the acquisition cost if historical costs and latest acquisition costs are not used.

Management Comments. DLA also took exception to the canned beef chunks example, NSN 8905-01-243-0099. DLA stated that the $4.14 price was based on the last representative buy in January 1995 and considered the $2.21 audit price not a representative buy.

Audit Response. In the canned beef chunks example, the procurement history identified that the last contract was awarded in November 1997. The price per can was $2.21. The procurement history provided only one additional contract for April 1996. The price per can was $3.32. No additional information existed in DISMS to support contract activity for canned beef chunks or any actual contracts to support the $4.14 per can DISMS acquisition price. Using the DLA-identified methodology for calculating acquisition costs, the $2.21 per can would be the reported acquisition cost. As discussed previously with black pepper, DLA needs to ensure policies and procedures that explicitly define the criteria for determining the acquisition cost if historical costs and latest acquisition costs are not used.

Management Comments. DLA stated that no requirement exists to either compare contract history with the Quarterly Variance Report or to calculate acquisition cost using on-hand quantities currently in the inventory. DLA stated that the NSNs within a menu that appear on the Federal Supply Catalog-Price List for Subsistence (C8900-PL) are priced and reviewed on a quarterly basis by the non-ration pricing analyst. Using the C8900-PL review, the ration pricing analyst uses the latest acquisition cost for each of these NSNs. For NSNs not published in the C8900-PL, the ration-pricing analyst conducts a review. Because these NSNs could be procured at different times in the year, DLA uses the latest acquisition cost in a representative contract to price each NSN within a menu.

Audit Response. At the time of our audit, an evaluation for determining the value assigned to an individual NSN in a ration menu was completed by a subsistence pricing analyst. The analyst was responsible for valuing both the ration NSNs and non-ration NSNs. The process provided to us showed the analyst's determination of the individual NSN value in a ration menu was not based on the latest acquisition cost or the latest representative contract, but the contract that was closest to the established value. No consistency was used in valuing the individual NSNs within a menu. Additionally, the valuation procedures were not documented and an audit trail did not exist.

Recommendations, Management Comments, and Audit Responses

B. We recommend that the Commander, Defense Supply Center Philadelphia:

1. Develop and implement procedures in the Defense Integrated Subsistence Management System to accurately compute acquisition costs used to value on-hand subsistence inventories based on the latest representative purchase price. The procedures should require the Defense Supply Center Philadelphia Pricing Activity to:

a. Fully document and maintain the methodology used to estimate acquisition costs and use the latest representative purchase price as a basis.

Management Comments. DLA partially concurred with the recommendation, stating that DLA follows Financial Management Regulation direction of the most recent representative contract price. DLA plans to review and document the procedures in completion of the current policy and plans by July 2001.

b. Use consistent acquisition cost data in the Defense Integrated Subsistence Management System.

Management Comments. DLA partially concurred and stated that using consistent acquisition cost data in DISMS was a DLA practice. DLA also stated that a discrepancy could exist between the ration menu items being priced annually (August) and the individual end item being priced quarterly. That procedure would result in the end item price being more representative than the ration menu item price.

c. Identify and correct the acquisition costs residing in the national inventory record file that were computed using the inaccurate methods identified by this audit.

Management Comments. DLA partially concurred with the recommendation. DLA stated that its cost methods were accurate. DLA stated that DSCP was actively trying to deplete stocks on NSNs that are to be procured under commercial practices.

Audit Response. Although DLA partially concurred with the recommendation, we do not consider its comments responsive. DSCP was actively trying to deplete stocks, however, the audit results showed that information in DISMS and the supporting documentation did not support the accuracy of DSCP cost methods. Additionally, the audit result showed that the subsistence financial data being report in DLA financial statements were not supportable. We request that DLA reconsider its position and provide additional comments in response to the final report.

d. Develop procedures that provide an audit trail for the manually calculated acquisition.

Management Comments. DLA concurred and stated that Business System Modernization should address the issue of storing pricing reports in an electronic format for a longer period than 15 months. DLA stated that pricing analysts will retain a hard copy of supporting documentation and methodology used to determine the price of annually priced items of FY 2002 in August 2001. Additionally, DSCP will consider pricing all subsistence NSNs annually upon implementation of Business System Modernization with the reduced activity of those NSN and creating a longer audit trail period.

e. Develop procedures that validate acquisition costs and on-hand assets used to compile the trial balance.

Management Comments. DLA concurred and stated that the long term solution to correct the material weakness this audit identified will be the

implementation of BSM. In the mean time, DISMS files are scanned for both inventory transactions and balances, and posted to the trial balance by DFAS using a journal voucher process.

Audit Response. Although DLA concurred with the recommendation, DLA comments are partially responsive. DLA should develop interim procedures to ensure the validity of the acquisition costs and on-hand assets used to compile the trial balance. Although DLA concurred with the recommendation, the response did not provide an estimated completion date. We request DLA reconsider this recommendation and provide an estimated completion date in response to the final report.

2. Establish a quality assurance program to ensure the accuracy of subsistence inventory prices. The program must include procedures to test the accuracy of prices for all items including inactive items.

Management Comments. DLA concurred with the recommendation. DLA stated that its item NSN inventory is reduced due to shifting to commercial practices. No inactive items are in its inventory. For the remaining NSNs in the supply system, acquisition costs are and will continue to be priced based on representative latest acquisition cost. DLA stated for the remaining ration items in the system, acquisition prices are priced manually on an annual basis; individual NSNs acquisition costs are reviewed monthly and updated based on the most recent procurement activity.

Audit Response. Although DLA concurred with the recommendation, we do not consider its comments responsive. DLA comments to this recommendation conflict with comments provided earlier to the finding. In response to the finding, DLA stated individual NSNs are valued and reviewed on a quarterly basis and represent the latest acquisition costs. However, DLA comments to this recommendation state that all NSNs are valued and reviewed monthly and are priced based on representative latest acquisition costs. The audit results showed that DLA was valuing NSNs at something other than latest acquisition costs. We request DLA provide additional comments to the final report.

3. Develop and implement procedures to identify the total subsistence inventory value for items with acquisition costs not supported by obligation history records and require that the acquisition costs for those items be estimated based upon current manufacturer's price listings or market price quotations. Additionally, develop and implement procedures to disclose the total inventory value for items with acquisition costs based on obligation history records provided by the previous managing inventory control point for logistic gain items and acquisition costs based on Defense Supply Center Philadelphia obligation history records more than 6 years old.

Management Comments. DLA partially concurred and stated that most subsistence items have a short shelf life and a high turnover rate, resulting in up-to-date prices. DLA identified that NSNs with old procurements are being purchased through prime vendors and no longer impact inventory because the

inventory has been deleted and no longer stocked. The remaining NSNs are ration items and priced at the representative latest acquisition costs.

4. Develop procedures that validate the inventory reported on the subsistence trial balance and provide an audit trail.

Management Comments. DLA concurred and stated that problems exist with the current financial accounting system. Plans to update the program were discontinued. DLA plans to address this issue in the Business System Modernization implementation.

Audit Response. We consider DLA comments to be partially responsive. We request DLA provide a completion date for this action in its response to the final report.

Appendix A. Audit Process

Scope

We performed this audit as part of the requirements of Public Law 101-576, the "Chief Financial Officers Act of 1990," November 15, 1990, as amended by Public Law 103-356, the "Federal Financial Management Act of 1994," October 13, 1994. For this part of the audit, we limited the scope of our review to verifying the accuracy of inventory valuation information at DSCP.

Work Performed. We performed the audit at DLA headquarters, DSCP, and the DLA Systems Integration Office. We analyzed the acquisition costs for a review of 728 DSCP-managed NSNs to determine whether the acquisition costs were calculated in accordance with Federal accounting policy. The analysis included verifying the acquisition costs to the originating detailed transaction data (the contract). As part of our audit, we reviewed numerous inventory-related documents including:

- Federal accounting policy, DoD financial management regulations, and DLA procedures and policies on valuing and reporting inventories;
- File interrogation reports for each applicable review item from the SAMMS standard pricing master file, national inventory record file, and the logistics reassignment data file;
- DLA Systems Integration Office documents describing SAMMS Pricing System;
- Procurement history reports from the Information Handling Service's Haystack Windows Online Service for each applicable reviewed item;
- DD Form 1155, "Order For Supplies Or Services," and related contracting documents supporting obligation records used in calculating the acquisition cost for each applicable reviewed item;
- SAMMS transaction history file reports (for the maximum 24-month period) for items that were found to be inaccurately priced; and
- DISMS quarterly item price lists and contract history reports for each applicable review item.

We verified the acquisition cost for each item by obtaining contract data at the managing inventory control point because the acquisition cost in DLA is updated when a contract is awarded and not upon the receipt of goods. In addition, we did not believe that sufficient invoice data would be available at the DLA distribution depots because they are required to retain copies of receipt invoices (DD Form 250, "Material Inspection and Receiving Reports") for a period of

only 2 years. In addition, we believed that the significant relocation of inventories resulting from Defense Base Realignment and Closure actions would also limit the availability of original invoice data.

Limitations to Audit Scope. Our audit work was limited to determining whether the acquisition costs used to value DSCP inventory were based on Federal accounting policy and supported by contract data. We did not assess the reasonableness of the price paid for the items or the reasonableness of the DSCP surcharge rates.

DoD-Wide Corporate-Level Government Performance and Results Act Goals. In response to the Government Performance and Results Act, 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 goal:

FY 2001 DoD Corporate-Level Goal 2: Prepare now for an uncertain future by pursuing a focused modernization effort that maintains U.S. qualitative superiority in key warfighting capabilities. Transform the force by exploiting the Revolution in Military Affairs, and reengineer the Department to achieve a 21st century infrastructure. (01-DoD-2)

- **FY 2001 Subordinate Performance Goal 2.5:** Improve DoD financial and information management. **(01-DoD-2.5)**

- **FY 2001 Performance Measure 2.5.2:** Achieve unqualified opinions on financial statements. **(01-DoD-2.5.2)**

DoD Functional Area Reform Goals. Most major DoD functional areas have also established performance improvement reform objectives and goals. This report pertains to achievement of the following functional area objectives and goals.

- **Financial Management Functional Area. Objective:** Reengineer DoD business practices. **Goal:** Standardize, reduce, clarify, and reissue financial management policies. **(FM-4.1)**

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 Financial Management and Inventory Management high-risk areas.

Methodology

We reviewed Federal accounting standards, DoD, and DLA policies and procedures for valuing inventories. We also interviewed various DSCP personnel involved in the inventory valuation process including procurement specialists and pricing analysts. In addition, we interviewed computer specialists at the DLA System Integration Office who were responsible for supporting SAMMS Pricing System.

We performed a review of the acquisition costs used to value 728 DSCP-managed NSNs on the SAMMS NIRF, which serves as the source file for the on-hand non-subsistence inventory value on the DSCP Stock Fund Trial Balance. We interrogated the SAMMS SPMF for each item to determine the methodology used to calculate the acquisition cost. We also reviewed the Trailer data section of the SAMMS Pricing System to determine if there were obligation records to support the acquisition cost. In addition, we reviewed Procurement History reports from the Information Handling Service's Haystack Windows Online Service for each NSN to determine if obligation records supported the acquisition cost. We also reviewed SAMMS logistics reassignment data files for each item. For items with obligation records that supported the acquisition cost, we requested the contract folder from the appropriate DSCP activity. We reviewed the contract folder for each item to determine if the obligation data maintained in the SPMF was complete and accurate, and reflected the last representative invoice price as defined by generally accepted accounting principles. For items that were found to be inaccurately valued, we obtained SAMMS Transaction History File reports for the maximum 24-month period available to determine whether any assets had been sold at the inaccurate price. Additionally, we obtained the DSCP surcharge rates for FY 1999 to calculate the impact that the inaccurate acquisition costs had on the standard price.

Universe and Sample. Of the 728 items we reviewed, 695 items were part of a DLA-wide sample of 3,153 records selected as part of a sampling plan that DLA executed to assess the accuracy of its FY 1999 financial statement inventory valued. In June 1999, DLA fielded a sampling plan to test the accuracy of the portion of its inventory stored at 18 DLA distribution depots operating under the Distribution Standard System. As part of that effort, DLA used a two-stage, stratified, random sampling procedure to select a sample of 3,153 records from the Distribution Standard System operating files at 11 DLA distribution depots for the period ending June 30, 1999. NSN by location (all condition codes) served as the unit of analysis or sample record. Inventory values for the 3,153 records were determined using the acquisition cost from the SAMMS operating files at the managing DLA inventory control points.

In our review of the DLA sampling plan, we reported that the plan did not include procedures to test the accuracy of the unit prices in the SAMMS operating files at the managing DLA inventory control points. We decided to test the accuracy of the 3,153 records in SAMMS. Of the 3,153 records, 754 were identified in the Distribution Standard System as being managed by DSCP. During our review, we found that 6 of the 754 NSNs management responsibility had transferred from DSCP to the Defense Supply Center Richmond. Additionally, we found that 53 items had zero on-hand assets. Removing those 59 items left the total number of DSCP-managed items with on-hand assets selected as part of the DLA sampling plan at 695.

In addition to the 695 items, a judgmental review of 36 items was selected for review from the SAMMS NIRF, which serves as the source file for the inventory amounts reported on the financial statements. The 36 items were selected as part of our review to provide greater coverage of the unusually low

and high acquisition costs and acquisition costs lacking an acquisition cost code. During our review, we found that three items had zero on-hand assets. After eliminating these items, the total number of items reviewed managed by DSCP was 728. This report will not project the results from the 728 items to the DSCP total inventory universe. However, we will comment on the total 3,153 records selected as part of the DLA Sampling Plan in a summary report.

The DLA Sampling Plan did not include sampling the subsistence commodity. The deficiency was addressed in the Inspector General, DoD, Report No. D-2000-138, "Procedures Used to Test the Dollar Accuracy of the Defense Logistics Agency Inventory," June 1, 2000. As a result, DLA provided the subsistence data to the Inspector General, DoD, in October 1999. We judgmentally reviewed the subsistence commodity. A total of 15 storage locations were identified with a total number of 634 NSNs. We judgmentally reviewed 81 of 634 NSNs.

Use of Computer-Processed Data. To achieve the audit objective, we relied on computer-processed data from the DLA SAMMS. We did not test the general and application controls in SAMMS. Specifically, we analyzed the acquisition costs and obligation history data in the NIRF and SPMF.

Of the 728 items we reviewed, we determined that the computer-processed acquisition cost data were unreliable for 194 items in the NIRF. We were not able to determine the reliability of the computer-processed acquisition cost data in the SPMF for 405 items because DSCP could not provide the obligation history records (28 items) or the originating contract files (377 items). The computer-processed acquisition cost and supporting obligation history data in the SPMF were reliable for 129 of the 728 items that we reviewed because we were able to verify the accuracy of the information to source documents.

Audit Type, Dates, and Standards. We performed this financial-related audit from October 1999 through March 2001 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We did our work in accordance with generally accepted Government auditing standards except that we were unable to obtain an opinion on our system of quality control. The most recent external quality control review was withdrawn on March 15, 2001, and we will undergo a new review.

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

Management Control Program Review

DoD Directive 5010.38, "Management Control Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of those controls.

Scope of the Review of the Management Control Program. We reviewed the FY 1999 Annual Statement of Assurance issued by DLA to determine whether the issues addressed in this report had been reported as material management control weaknesses.

Adequacy of Management Controls. We identified material management control weaknesses, as defined by DoD Instruction 5010.40, related to the valuation of DSCP-managed inventory. The details of the management control weaknesses are provided in the finding section of this report. The recommendations in this report, if implemented, will improve the accuracy and reliability of the DSCP inventory values. A copy of this report will be provided to the senior official responsible for management controls at DSCP.

Adequacy of Management's Self-Evaluation. The FY 1999 DLA Annual Statement of Assurance did not identify any material control weaknesses related to the valuation of DSCP-managed inventory.

Prior Coverage

Inspector General, DoD, Report No. D-2001-078, "Inventory Valuation at the Defense Supply Center Richmond," March 14, 2001

Inspector General, DoD, Report No. D-2001-079, "Inventory Valuation at the Defense Supply Center Columbus," March 14, 2001

Inspector General, DoD, Report No. D-2000-138, "Procedures Used to Test the Dollar Accuracy of the Defense Logistics Agency Inventory," June 1, 2000

Inspector General, DoD, Report No. D-2000-086, "Assuring Condition and Inventory Accountability of Chemical Protective Suits," February 25, 2000

Appendix B. Acquisition Cost Calculation

As described by DLA Manual 7000.2, Volume II, Part I, "Standard Automated Material Management System Financial Subsystem Operating Procedures," July 1, 1999, the acquisition cost calculation is an automated process that the Pricing System performs within the SAMMS financial subsystem. SAMMS maintains one acquisition cost value for each NSN without regard to the number of assets on hand. The acquisition cost is recomputed as new procurement actions occur. The acquisition cost for an item is equivalent to its average replacement cost as calculated from obligation history records contained on the SPMF. The acquisition cost is the sum of all eligible obligation amounts divided by the sum of their obligation quantities plus GFM costs and any other applicable costs contained on the SPMF. Acquisition costs for stocked items are calculated using an average of all stock replenishment buys awarded during the past 6 months, plus any other stock replenishment buys that have occurred within 45 days of the latest stock buy. The quantity of the buys used must also be at least equal to one month's demand based on historical data. The mechanically recommended price changes are held in suspense at least 7 days to enable the Pricing Activity to review, revise, or delete as applicable.

Each item assigned an acquisition cost has a corresponding acquisition cost date and acquisition cost code. The acquisition cost date is the Julian date on which the acquisition cost became effective and should always be the first of the month. The acquisition cost code is a one-position field describing how the acquisition cost was developed. The acquisition cost codes are defined in the following table.

Definitions of Acquisition Cost Codes

Acquisition Cost Code	Definition
A	Acquisition cost was computer generated based on obligation transactions in the SPMF. The transactions may result from a DLA award or from obligation transactions provided by the previous inventory manager if the item was a logistics gain.
C	Acquisition cost was computed during a DLA-wide conversion from standard price to latest acquisition cost in July 1992, and no procurement action took place since the initial conversion.
E	Acquisition cost was estimated.
G	Acquisition cost was based on the standard price provided by the previous manager upon transfer of management responsibility to DLA.

Appendix C. Potential for Additional Acquisition Cost Inaccuracies

The following tables break down the DSCP by commodity. As depicted in Table C.1, the DSCP general and industrial commodity had 221,806 NSNs with on-hand assets having acquisition costs identified by acquisition cost codes "C" and "E," which represented 50 percent of the 442,507 DSCP-managed items with on-hand inventory. Additionally, the $343 million on-hand inventory value for those items represented more than 43 percent of the total $792 million DSCP inventory value as of September 30, 2000.

Table C.1 September 30, 2000, DSCP General and Industrial Inventory by Acquisition Cost Code

Acquisition Cost Code	NSNs with On-hand Assets	Percent of Total NSNs	Total On-Hand Inventory Value	Percent of Total Value
A	220,290	49.8	$447,461,778.90	56.49
C	129,447	29.3	60,684,158.10	7.66
E	92,359	20.9	282,687,210.21	35.69
Other	411	0.0	1,300,003.77	.16
Total	**442,507**	**100.0**	**$792,133,150.98**	**100%**

In Table C.2, the DSCP-clothing and textiles commodity had 10,157 NSNs with on-hand assets having acquisition costs identified by acquisition cost codes "C" and "E," which represented 48 percent of the 20,913 DSCP-managed items with on-hand inventory. Additionally, the $258 million on-hand inventory value for those items represented more than 28 percent of the total $901 million DSCP inventory value as of September 30, 2000.

Table C.2 September 30, 2000, DSCP Clothing and Textiles Inventory by Acquisition Cost Code

Acquisition Cost Code	NSNs with On-hand Assets	Percent of Total NSNs	Total On-Hand Inventory Value	Percent of Total Value
A	10,750	51.4	$643,375,109.62	71.36
C	2,817	13.5	33,646,170.93	3.73
E	7,340	35.1	224,747,325.54	24.92
Other	6	0.0	2,949.59	0.00
Total	**20,913**	**100.0**	**$901,589,555.68**	**100%**

In Table C.3, the DSCP medical commodity had 3,427 NSNs with on-hand assets having acquisition costs identified by acquisition cost codes "C" and "E," which represented 54 percent of the 6,315 DSCP-managed items with on-hand inventory. Additionally, the $63.9 million on-hand inventory value for those items represented more than 47 percent of the total $135 million DSCP inventory value as of September 30, 2000.

Table C.3. September 30, 2000, DSCP Medical Inventory by Acquisition Cost Code

Acquisition Cost Code	NSNs with On-hand Assets	Percent of Total NSNs	Total On-Hand Inventory Value	Percent of Total Value
A	2,887	46	$71,594,446.30	52.8
C	2, 067	33	23,475,438.92	17.3
E	1,360	21	40,501,574,.58	29.9
Other	1	0.0	625.00	0.00
Total	**6,315**	**100.0**	**$135,572,084.80**	**100%**

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
  Commander, Defense Supply Center, Philadelphia

Non-Defense Federal Organizations and Individuals

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform.
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FORT BELVOIR, VIRGINIA 22060-6221

IN REPLY REFER TO J-3

MAY 22 2001

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
DEPARTMENT OF DEFENSE

SUBJECT: Audit Report on Inventory Valuation at the Defense Supply Center Philadelphia, Project No. D2000FJ-0067.004

This is in response to your request for comments on the above draft report. If you have any questions, please contact Mr. William J. Kenny, 703-767-1400.

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

Attachment

Federal Recycling Program Printed on Recycled Paper

Subject: Inventory Valuation at the Defense Supply Center Philadelphia,
Project No. D2000FJ-0067.004

Finding A: For its non-subsistence items, the Defense Supply Center Philadelphia assertion that inventory valuation was both accurate and supported by contract data was not reliable. Of the 729 non-subsistence items statistically selected for review, the values assigned to 600 items (82.3 percent) were not accurately computed based on the latest representative obligations or were unsupported. (See page 2 of report).

DLA Comments: Partially Concur. The DLA procedure is to compute the latest representative acquisition cost using the weighted average acquisition cost of stocked items using the latest contract and any other buys made in the preceding 44 days. For nonstocked items, the weighted average of the prices of all buys in the last 6 month period from the most recent buy is used. DLA uses this weighted average method which dampens the impact of wide fluctuations in quantities and resulting unit prices that can occur within such short timeframes. This methodology is the best approach for the types of items managed by DLA. We do concur that the audit has identified areas where we can improve policies and procedures. In addition, the Defense Supply Center in Philadelphia researched the items in question. Based on the results, the error rates cited in the DODIG finding are incorrect. The following data is provided:

Items without Supporting Contracts
A total of 377 items lacked supporting contract files. A total of 174 of those items had contracts that exceeded the age retention requirements yet were counted as error items. Another 33 logistic reassignment items without supporting contract files were counted as errors although the Standard Automated Materiel Management System (SAMMS) manual simply requires items bear price code G for logistic gain pending center activity (purchase). Another 155 items had SAMMS obligation history but were counted as errors because supporting contracts could not be located. The contracts were within retention parameters. Today electronic files are the basis for obligations and disbursement. Comptroller Pricing doesn't receive paper contract copies and even if they did it may not be the latest value. The Defense Finance and Accounting Service (DFAS) disburses based on the values shown in the active contract file. Since a vendor will be paid (true cost) based on active contract file, we reason that file could have been used to audit pricing. Another 15 items were Deployable Medical System Assemblies for which supporting contracts could not be located. These assemblies are composed of thousands of individual items (NSNs) that are standard priced at assembly level by a special program. The program doesn't report acquisition cost at assembly level. To capture such cost, wholesale re-programming of requirements and financial needs would have to be done. There is currently a moratorium on systems changes to SAMMS because of DLA's Business System Modernization (BSM).

Items without Supporting Obligation History
For those items without supporting obligation 18 were logistic gains. IG advises that SAMMS was programmed to price those items at the standard price of the losing manager. Although this occurred in the early 1990s, the methodology was revised in FY92 removing 8.1 percent of the price as a proxy for the average surcharge included in standard prices inherited from the Services. These items would, of course be re-priced upon purchase by DLA. Other items were found in error and analysis will be conducted.

Recommendations A for Commander, Defense Supply Center Philadelphia:

1. Develop and implement procedures in the Standard Automated Materiel Management System to accurately compute acquisitions costs used to value on-hand non-subsistence inventories based on the latest representative purchase price. The procedures should require DSCP Pricing Activity to:

a. Fully document and maintain the methodology used to estimate acquisition costs and use the latest representative purchase price as a basis.

DLA Comments: Partially Concur. To determine the acquisition cost of an item, DLA uses the weighted average of costs from recent representative contract prices. We agree that the procedure should be fully documented, and included in DLAM 7000.2. Any Clothing and Textile (C&T) exceptions for bag, direct vendor delivery (DVD), or government furnished material (GFM) items will be duly noted. We will review the manual and ensure that the current policy is appropriately documented. Action to be completed by July 2001.

Disposition:
(X) Action is ongoing. ECD: July 31, 2001
( ) Action is considered complete.

b. Use consistent acquisition cost data in the national inventory record file and the standard pricing master file.

DLA Comments: Concur. This is the DLA practice. The standard pricing master file is the source of the acquisition costs data in the national inventory record file; however, instances can occur when an update to the standard pricing master file has not yet been recorded in the national inventory record file. At the end of every month, SAMMS reconciles the standard pricing master file with the national inventory record file and creates a report of change.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered complete.

c. Use the program developed by the Defense Logistics Agency System Integration Office to identify and correct all acquisition costs with a zero value at the end of each reporting period.

DLA Comments: Concur. This program is in place at DSCP.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered complete.

d. Identify and correct all acquisition costs residing in the national inventory record file that were computed using the inaccurate methods identified by this audit, including acquisition costs there were incorrectly estimated, acquisition costs incorrectly computed during the FY 1992 conversion to the latest acquisition costs inventory valuation method, and the acquisition costs erroneously based on canceled contracts.

DLA Comments: Partially Concur. DLA has found that our pricing methodology of averaging the most recent contracts to compute the prices results in more accurate pricing for the types of items that we manage. DLA will review the current DoD inventory valuation policies to ensure compliance of DLA policies and procedures, especially concerning the appropriateness of eliminating acquisition costs erroneously based on canceled contracts. Based on this review, DLA will take action as appropriate.

Disposition:
(X) Action is ongoing. ECD: September 28, 2001
( ) Action is considered complete.

2. Establish a quality assurance program to ensure the accuracy of inventory prices. The program must include procedures to test the accuracy of prices for all items including inactive items.

DLA Comments: Concur. The Defense Supply Center Columbus will develop a sampling program to test accuracy of inventory prices. Particular attention will be given to stratification by date of last procurement activity. We will coordinate with the other DLA Centers, including Philadelphia, to ensure a sampling program is already being utilized. Upon completion, a sampling program will be disseminated to the other Centers for use as appropriate.

Disposition:
(X) Action is ongoing. ECD: September 28, 2001
( ) Action is considered completed.

3. Develop and implement procedures to identify and disclose the value of on-hand inventories where contract data do not support acquisition costs. The procedures should identify the total inventory value for items with acquisition costs not supported by obligation history records and require that the acquisition costs for those items be estimated based upon current manufacturer's price listings or market price quotations. Additionally, the disclosure should provide the total inventory value for items with acquisition costs based on obligation history records provided by the previous managing inventory control point for logistics gain items and acquisition costs based on Defense Supply Center Philadelphia obligation history records more than 6 years old.

DLA Comments: Partially Concur. We agree in principle with the intent of the recommendation. However, although DoD Financial Management Regulation permit estimating acquisition cost for items without a procurement history based on current manufacturer's price listing or market price quotations, this approach is not mandated (see Volume 11B, Chapter 55, page 55-17). Because adoption of this approach would require an intensive manual effort, we

will assess the costs and benefits of changes of this and alternative solutions prior to implementation.

Disposition:
(X) Action is ongoing. ECD: July 31, 2001
( ) Action is considered complete.

4. Develop and implement procedures to retain contract data to support the acquisition costs used to value on-hand inventories on the financial statements. The procedures should require the retention of the latest representative obligation history record in the purchase trailer of the standard pricing master file and require the retention of supporting contract files in accordance with Defense Logistics Agency retention requirements.

DLA Comments: Partially Concur. DLA retains contract files in accordance with the Federal Acquisition Regulation. Retention beyond these timeframes for items that have not been procured beyond this period would have far reaching impact not only DLA but the Military Services. The Military Services would also be required to retain and pass these records upon logistics reassignments. This recommendation should be readdressed to the Under Secretary (Comptroller) for review and comment.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered complete.

Finding B: For the subsistence commodity, the DSCP assertion that inventory valuation was both accurate and supported by contract data was not reliable. Of the 81 items selected for review with on-hand inventories valued at $204 million, the values assigned to 49 items valued at $192 million were not accurately computed based on the latest representative obligations or fully supported by the originating contract files.

DLA Comments: Partially Concur. It should be noted that less than 20 percent of the items subsistence manages are standard priced. Prices for Produce as well as Food Service items provided by a Prime Vendor are updated on a weekly basis. Those items that are standard priced are primarily operational rations; either end-items ore components, and are manually priced each year. A couple of the items that were included in this inventory sample were those remaining in our supply system but have since been depleted.

As stated above in Finding A, The DLA procedure for computing standard price is to use the latest representative acquisition cost using the weighted average is to compute the latest representative acquisition cost using the weight average acquisition cost of stocked items using the latest contract and any other buys made in the preceding 44 days. For nonstocked items, the weighted average of the prices of all buys in the last 6 month period from the most recent buy is used. We concur that the audit has identified areas where we can improve policies and procedures. In addition, the Defense Supply Center in Philadelphia researched the items in question based on the results, the error rates cited in the DODIG finding are incorrect. The following data is provided:

In the example of black pepper, NSN 8950-00-127-8067, the $1.76 price DSCP provided was based on large quantity buys in the early 1990s. The $2.90 price stated by the audit as the last contract award price was based on a small buy that was not representative of 60,932 inventory quantity on hand. During the time of the audit, Subsistence was actively reducing inventory on this item due to a shift to commercial practices. If the $2.90 price was used to value inventory, this inaccurate acquisition cost would have overstated inventory by $69,462.48. In addition, all inventories on this item have since been depleted.

Canned beef chunks, NSN 8905-01-243-0099, the $4.14 price was based on the last representative buy in January 1995. The $2.21 price used by the auditors was inaccurate because it was not based on what we would consider a representative buy. If the $2.21 price were used to value inventory, this would have understated the inventory by $682,425.30.

The audit report states that there is neither a requirement to compare contract history with the Quarterly Variance Report nor to calculate acquisition cost using on-hand quantities currently in the inventory. This is incorrect. The ration menu items are priced on an annual basis in the month of August prior to the start of the fiscal year. The NSNs within a menu that appear on the C8900-PL are priced and reviewed on a quarterly basis by the non-ration pricing analyst. Since these NSNs have already been reviewed, the ration-pricing analyst uses the latest acquisition cost for each of these NSNs. The remaining NSNs not published in the C8900-PL are reviewed by the ration-pricing analyst. This is accomplished by reviewing the 15 month history in DISMS and/or talking to supply personnel to verify pricing data shown in DISMS. Since these items are procured at different times throughout the year, we use the latest acquisition cost in a representative contract to price each NSN within a menu.

Recommendation B for Commander, Defense Supply Center Philadelphia:

1. Develop and implement procedures in the Defense Integrated Subsistence Management System to accurately compute acquisitions costs used to value on-hand subsistence inventories based on the latest representative purchase price. The procedures should require DSCP Pricing Activity to:

a. Fully document and maintain the methodology used to estimate acquisition costs and use the latest representative purchase price as a basis.

DLA Comments: Partially Concur. To determine the acquisition cost of an item, DLA uses the most recent representative contract prices as directed by the Financial Management Regulation, Chapter 9, Volume IIb. We agree that the procedure should be fully documented, and included in DLAM 7000.2. We will review the manual and ensure that the current policy is appropriately documented. Action to be completed by July 2001.

Disposition:
(X) Action is ongoing. ECD: July 31, 2001
( ) Action is considered complete.

b. Use consistent acquisition cost data in the DISMS.

DLA Comments: Partially concur. This is the DLA practice; however, a discrepancy could exist because the ration menu items (except UGRs) are priced on an annual basis in the month of August prior to the started of the fiscal year in October. The end item, an individual NSN, is priced on a quarterly basis. It is possible that this end item could have a later procurement and would be priced appropriately if it was deemed to be representative.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered complete.

c. Identify and correct the acquisition costs residing in the national inventory record file that were using the inaccurate methods identified by this audit.

DLA Comments: Partially concur. DLA uses accurate methods to determine costs. At the time of the audit, DSCP was actively trying to deplete stocks on NSNs that are no longer being procured due to the shift to commercial practices. Many of the 81 NSNs used in the audit fall into this criteria. The only NSNs being procured outside of rations are small non-representative overseas procurements. The DSCP pricing activity overrides these overseas procurements because they are small non-representatives buys that may or may not match the NSN they are placed against. These buys are not placed against inventory and are procured locally and shipped to the customer. The issue of small busy may be addressed during the implementation of BSM. DSCP will continue to review its prices and make corrections as appropriate.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered complete.

d. Develop procedures that provide an audit trail for the manually calculated acquisitions.

DLA Comments: Concur. DSCP provides audit trails in DISMS for up to 15 months and store the pricing reports for up to one year. BSM should address the issue of storing these reports in an electronic format for a longer period of time. DSCP will look into pricing all subsistence NSNs annually upon implementation of BSM due to the reduced activity of these NSNs because of the shift to commercial practices. This will reduce the volume of paper reports resulting in more storage space for pricing review and creating a long audit trail period. The subsistence pricing analyst will retain a hard copy of the supporting documentation and methodology used to determine the price of the annually priced ration items beginning with the FY02 prices in August 2001.

Disposition:
(X) Action is ongoing. ECD: September 1, 2001
( ) Action is considered complete.

e. Develop procedures that validate acquisition costs on-hand assets used to compile the trial balance.

DLA Comments: Concur. There are systems shortcomings in the current financial accounting system, general ledger and financial reports as generated by DISM. Because of a DFAS decision to put the final phase of DISMS development on hold, a financial module does not currently exist. DISMS files are currently scanned for both inventory transactions and balances and posted to the trial balance by DFAS using a journal voucher process. The long-term solution that will correct the materiel weakness that this audit has identified is the implementation of BSM.

Disposition:
(X) Action is ongoing. ECD: TDB as BSM is established
( ) Action is considered complete.

2. Establish a quality assurance program to ensure the accuracy of subsistence inventory prices. The program must include procedures to test the accuracy of prices for all items including inactive items.

DLA Comments: Concur. Most of the NSNs in the C8900-PL are no longer being procured through the traditional methods due to shifts to commercial practices. Subsistence does not have any inactive items in inventory. The items remaining in the supply system are and will continue to be priced based on representative latest acquisition cost. Of the items remaining in the system, most are priced manually on an annual basis, others are reviewed monthly and updated based on the most recent procurement activity.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered completed.

3. Develop and implement procedures to identify and disclose the total subsistence inventory value for items with acquisition costs not supported by obligation history records and requires that the acquisition costs for those items be estimated upon current manufacturer's price listings or market price quotations. Additionally, develop and implement procedures to disclose that total inventory value for items with acquisition costs based on obligation history records provided by the previous managing inventory control point for logistic gain items and acquisition costs based on Defense Supply Center obligation history records more than 6 years old.

DLA Comments: Partially Concur. However, most of the subsistence items have a short shelf life in comparison to other commodities. The subsistence inventory has a higher turnover rate resulting in up to date prices. The NSNs that are based on old procurements are being purchased through prime vendor and no longer impact inventory because these items have not been stocked since the inventories on these items have been depleted. The remaining NSNs for ration items are priced based on representative latest acquisition cost.

Disposition:
( ) Action is ongoing. ECD:
(X) Action is considered complete.

4. Develop procedures that validate the inventory reported on the subsistence trial balance and provide an audit trail.

DLA Comments: Concur. As stated above, DLA concurs that there are problems with the current financial accounting system. There were plans to update the financial system within DISMS Increment VI but the program was discontinued after Increment V implementation. This will be addressed in the BSM implementation.

Disposition:
(X) Action is ongoing. ECD: TBD based on BSM implementation schedule.
( ) Action is considered complete.

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