

**A**udit



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CONTRACT TERMINATIONS AT DEFENSE SUPPLY CENTER  
COLUMBUS AND DEFENSE SUPPLY CENTER RICHMOND

Report Number 98-172

July 2, 1998

Office of the Inspector General  
Department of Defense

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### **Acronyms**

CIT	Consumable Item Transfer
DLA	Defense Logistics Agency
DSCC	Defense Supply Center Columbus
DSCR	Defense Supply Center Richmond
GAO	General Accounting Office
ICP	Inventory Control Point
NSN	National Stock Number
SAMMS	Standard Automated Materiel Management System
SPR	Special Program Requirement



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

July 2, 1998

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

**SUBJECT: Audit Report on Contract Terminations at Defense Supply Center  
Columbus and Defense Supply Center Richmond (Report No. 98-172)**

We are providing this report for your review and comment. This report is the second in a series of reports regarding the Defense Logistics Agency process of identifying, reviewing, and terminating excess procurements at its supply centers. 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. Therefore, we request that the Navy provide additional comments on Recommendation 1. and the Defense Logistics Agency provide additional comments on Recommendations 2.a., d., and e. by September 1, 1998. We request the Defense Logistics Agency also provide comments on the potential monetary benefits.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Tilghman A. Schraden at (703) 604-9186 (DSN 664-9186), e-mail [tschraden@dodig.osd.mil](mailto:tschraden@dodig.osd.mil) or Ms. Kathryn L. Palmer at (703) 604-8840 (DSN 664-8840), e-mail [kpalmer@dodig.osd.mil](mailto:kpalmer@dodig.osd.mil). See Appendix E for the report distribution. The audit team members are listed inside the back cover.

*David K. Steensma*

David K. Steensma  
Deputy Assistant Inspector General  
for Auditing



## Office of the Inspector General, DoD

Report No. 98-172  
(Project No. 7LD-3011)

July 2, 1998

### Contract Terminations at Defense Supply Center Columbus and Defense Supply Center Richmond

#### Executive Summary

**Introduction.** In its testimony before Congress, the General Accounting Office stated that about \$34 billion, about half of the DoD inventory of secondary items, was not needed to support war reserve or current operating requirements. As part of its National Performance Review Reinvention Impact Center, DoD set a goal of reducing DoD inventory by \$12 billion by the year 2000. DoD incorporated the goal into its Government Performance and Results Act plan. DoD inventory control points, which manage spare and repair parts, procure supply items, and award contracts, initiate contract terminations to avoid the purchase of unneeded inventory. Defense Logistics Agency (DLA) inventory control points are located at four supply centers. From September 1996 to July 1997, the DLA supply centers, excluding the Defense Supply Center Philadelphia,<sup>1</sup> had 38,192 purchases in process, valued at about \$664 million, for materiel that potentially exceeded requirements. Included in those totals, the Defense Supply Center Columbus and the Defense Supply Center Richmond had 19,803 purchases in process, valued at about \$522 million.

**Audit Objectives.** The overall audit objective was to determine whether the DLA wholesale inventory control points terminated the procurement of excess quantities of materiel in response to reduced inventory requirements. Specifically, we followed up on the recommendations made in Inspector General, DoD, Report No. 93-146, "Contract Terminations at DoD Wholesale Inventory Control Activities," June 30, 1993. We included a review of the management control program as it applied to the audit objectives. This report focused on two DLA inventory control points: the Defense Supply Center Columbus and the Defense Supply Center Richmond. A subsequent report will address the same audit objectives at the two remaining supply centers.

**Audit Results.** The Defense Supply Center Columbus and the Defense Supply Center Richmond did not aggressively pursue terminations of contracts and purchase requests for materiel that potentially exceeded requirements. Of 251 notices of excess procurement, valued at \$179.3 million, about \$47.1 million of materiel on order were not effectively reviewed and promptly processed over a 10- or 11-month period. As a result of the audit, \$2.4 million of the \$47.1 million was terminated by the two supply centers. An additional \$10.7 million was received in inventory. Until improvements are made in the termination process for contracts and purchase requests, DLA is at increased risk of adding unneeded materiel to the supply inventory.

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<sup>1</sup>Defense Supply Center Philadelphia could not provide data on the value of notices of excess procurement because the termination model based on the Standard Automated Materiel Management System was not operational.

DLA had not completed correcting the material management control weakness on untimely contract terminations at wholesale inventory control points that was reported in Inspector General, DoD, Report No. 93-146 (Appendix A).

Implementing the recommendations should contribute to reducing DoD supply inventories consistent with the DoD goals. Terminating contracts and purchase requests for excess procurements could result in up to \$34 million of potential monetary benefits in addition to the \$2.4 million realized during the audit. See Part I for a discussion of the audit results.

**Summary of Recommendations.** We recommend that the Navy and the Air Force supply centers provide DLA with information on consumable item transfers and contracting officers execute timely terminations. We recommend that DLA develop controls to ensure timely review and action on notices of excess procurement and recommendations for termination; follow guidance that requires specific documentation of customer-forecasted requirements; apply uniform thresholds to the review of consumable item transfers; include prompt resolution of notices of excess procurement as a performance indicator in DLA plans; and perform a special review to determine if excess procurements could be terminated.

**Management Comments.** The Navy concurred with the recommendation, but stated that the Navy inventory projections will take precedence over DLA. The Air Force agreed to send a memorandum to the Air Logistics Centers that reemphasizes the need to follow the DoD guidelines for timely responses. DLA concurred, stating that milestones for correcting the existing material control weakness will establish a system of controls for the timely review and tracking of termination actions. DLA also stated that it sent a policy letter to its supply centers on customer-forecasted requirements; that it will implement revised contract review thresholds; that it will achieve the necessary improvements in the resolution of notices of excess procurements through existing goals and strategies addressing process timeliness; and that it initiated the review of 59 items to determine if the items were excess and processed in accordance with guidelines. See Part I for a discussion of management comments and Part III for the complete text of management comments.

**Audit Response.** Although the Navy comments were partially responsive, it did not provide specific actions and completion dates to ensure Navy item managers would be responsive to DLA requests for information and recommendations to terminate contracts for consumable items. The Air Force comments were responsive. The DLA comments were partially responsive. DLA has revised the target date, and associated milestones, for correcting a material control weakness on timely contract terminations every year since 1993 but has yet to correct the weakness. DLA did not provide specific details on whether performance indicators were implemented in guidance to supply centers or added to the Supply Center Annual Performance Plans' overprocurement goals. Based on DLA comments to the draft report, we revised the recommendation for DLA to review notices of excess procurements and terminate those items that are excess. We request that the Navy and DLA provide additional comments to the final report by September 1, 1998.

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## **Part I - Audit Results**

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## Audit Background

**Defense Inventory Management.** In February 1997, the General Accounting Office (GAO) identified DoD inventory management as a high risk management problem in its "High Risk Series: An Overview," GAO/HR-97-1. In its testimony before the House Subcommittee on National Security, International Affairs, and Criminal Justice, on "Defense Inventory Management," March 20, 1997, GAO maintained that about \$34 billion, or about half of the DoD \$69.6 billion inventory of spare parts and other secondary inventory items was not needed to support war reserve or current operating requirements.

Consistent with the GAO testimony, the DoD set goals of reducing inventory. In the 1996/1997 edition of the DoD Logistics Strategic Plan, DoD set inventory reduction as one of several goals aimed at streamlining the logistics infrastructure. The DoD Logistics Strategic Plan for 1996/1997 states that every logistics dollar expended on unneeded inventory is a dollar not available to build, modernize, or maintain warfighting capability.

**Role of Inventory Control Points.** The DoD supply system uses wholesale inventory control points (ICPs) to manage spare and repair parts and other consumable items. The Defense Logistics Agency (DLA) manages four ICPs: Defense Supply Center Columbus (DSCC), Defense Supply Center Richmond (DSCR), Defense Industrial Supply Center Philadelphia, and Defense Supply Center Philadelphia. ICPs procure supply items based on customer demand factors obtained from several sources. Those sources include records of reported inventory on hand and on order, historical demand, and customer forecasts of demand. Customer forecasts of demand include planned maintenance as well as changes to historical use. ICPs may award contracts for materiel in excess of requirements due to changes in demand. For example, when changes occur in authorizations or quantities of weapon systems being supported due to a change in a military mission, the need for on-hand and on-order material may change for those systems. Additionally, attrition, changes in demand, repair, and other factors that justified procurement of the items can cause ICPs to have unneeded material on order from contractors.

**Guidance on Contract Terminations.** DoD policy on contract terminations is contained in DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," January 25, 1993. The regulation includes guidance on ICP procedures and responsibilities for item managers and contracting officers in determining and processing contract terminations. Additional guidance was issued on business rules for consumable item transfers that affect contract terminations. The Federal Acquisition Regulation, subpart 49.101, "Authorities and Responsibilities," requires that contracting officers terminate unneeded materiel from contracts when it is in the Government's best interest. See Appendix C for a discussion of guidance on contract terminations.

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## Audit Objectives

The overall audit objective was to determine whether the DLA wholesale ICPs terminated the procurement of excess quantities of materiel in response to reduced inventory requirements. Specifically, we followed up on the recommendations made in Inspector General, DoD, Report No. 93-146, "Contract Terminations at DoD Wholesale Inventory Control Activities," June 30, 1993 (Inspector General, DoD, Report 93-146). Additionally, we evaluated DLA criteria and termination models for determining the benefits of terminating excess materiel on contract, and the effectiveness of contract termination policies. We included a review of the management control program as it applied to the audit objectives. The audit focused on two DLA inventory control points, DSCC and DSCR. A subsequent report will address the same audit objectives for the Defense Industrial Supply Center Philadelphia and the Defense Supply Center Philadelphia. See Appendix A for a discussion of the audit scope and methodology and our review of the management control program. See Appendix B for a summary of prior coverage.

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## Excess Procurement Termination Process

DSCC and DSCR did not aggressively pursue potential terminations of contracts and purchase requests for materiel that exceeded requirements. Of 251 notices of excess procurement<sup>1</sup> valued at \$179.3 million, we identified approximately \$36.4 million of potentially excess materiel on order that had not been effectively reviewed and promptly processed over a 10- or 11-month period<sup>2</sup> at the ICPs. The condition occurred because DLA did not institute procedures and controls that ensured the timely review and prompt processing of termination actions at DSCC and DSCR and the input of accurate data into internal termination models. Additionally, DLA did not establish uniform dollar thresholds to effectively manage consumable items transferred from the respective Military Departments, and Navy and Air Force ICPs did not provide the required information. Finally, DLA did not place sufficient management emphasis on contract terminations. The purchase of excess materiel resulted in lost opportunities to reduce the DoD inventory of secondary items, as well as lost opportunities to put funds to better use.

### Pursuit of Potential Terminations

DSCC and DSCR did not aggressively pursue potential terminations of contracts and purchase requests for materiel that exceeded requirements. The Inspector General, DoD, Report No. 93-146 reported that, historically, the ICPs terminated only a small portion (from 2.4 percent to 8.6 percent) of the materiel on contract when their automated system identified quantities as exceeding forecasted requirements. We reviewed a judgmental sample of 251 notices of excess procurement from the two ICPs. Only 25 of the procurements associated with those 251 notices were terminated by the ICPs prior to our audit.

**Sample Items.** For a 10- or 11-month period, September 1996 through July 1997, DSCC and DSCR had notices of excess procurement for 19,803 purchases valued at about \$522 million. From those notices, we selected for review 251 items with a value of about \$179.3 million. Although the 251 items represented only about 1.3 percent of the total number of items listed on the notices of excess procurement, the sample items accounted for about 34 percent of the total dollar value of the items identified as potentially excess procurements at DSCC and DSCR.

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<sup>1</sup>Notice of excess procurement is used throughout this report to refer to the sample group of "due-in studies" that contained a notice of potentially excess procurement.

<sup>2</sup>Data available for the DSCC sample covered a 10-month time period, September 1996 through June 1997; the sample data for DSCR covered an 11-month period, September 1996 through July 1997.

**Potential Terminations.** Of the sampled \$179.3 million in materiel, contracts and purchase requests for \$47.1 million potentially exceeded future requirements for the 10- or 11-month period. During that time period, DSCC and DSCR had reviewed the notices of excess procurement and determined that \$124.2 million of the \$179.3 million of potential excess procurements was not in actual excess of inventory requirements. ICP reviews of the sample items also identified potential excess procurements in the amount of \$8 million that were terminated by the two ICPs prior to our audit. As a result of our memorandums requesting information during the audit, DSCC and DSCR terminated an additional \$2.4 million of the \$47.1 million that we identified as potentially excess. For example, we requested information from a DSCC item manager to determine why procurements of a fuel overhaul kit (National Stock Number [NSN] 2910-01225-7200) were not terminated. According to the data provided by the Standard Automated Materiel Management System (SAMMS), demands for that item had decreased to zero. In response to our October 6, 1997, memorandum requesting information, the contracting officer canceled the procurement at no cost effective October 14, 1997, at a savings of \$317,170. Although item managers responded to the audit memorandums, responses provided lacked detailed justifications for not taking termination actions on \$44.7 million in potentially excess procurements. The table in Appendix D depicts the status of terminations for the items reviewed at DSCC and DSCR.

As a followup to our analysis, we obtained data at the end of January 1998 from DSCC and DSCR on the status of the \$44.7 million in procurements that we had identified as potentially excess. DSCC retained orders for sample items totaling about \$2.2 million. DSCR retained orders for sample items in the amount of about \$31.8 million. Although the total value of the notices of excess procurements had been reduced by about \$10.7 million to \$34 million, the reduction was primarily the result of receipt of inventory rather than cancellation of procurements.

### Timeliness of Termination Actions

DLA did not institute procedures and controls that ensured the timely review and prompt processing of termination actions at DSCC and DSCR to curtail procurements of unneeded materiel. Prompt action is critical as soon as it is realized that previous requirements are no longer valid because contractors continue production and incur additional cost for which the Government is liable.

**Processing Time.** Of the 251 sample items at DSCC and DSCR, 172 sample items were processed beyond the 30 days required by DoD 4140.1-R (see Table 1). For 51 of those sample items, ICP personnel did not take timely action to obtain data required to determine the economic benefits of terminations or to terminate the purchases when the models specified that termination would be beneficial. On the remaining 121 sample items, DSCC and DSCR had insufficient documentation to evaluate the timeliness of termination actions. Item managers at DSCC documented the timeliness of their review in most instances. DSCR was responsible for the majority (104) of the items that lacked

## Excess Procurement Termination Process

sufficient documentation. Although DoD Regulation 4140.1-R requires that ICPs maintain appropriate records to ensure accountability of reduction decisions, DLA and the two ICPs did not have procedures in place that tracked timeliness of review.

**Table 1. Processing Time of Sample Items**  
(dollars in millions)

Time (days)	DSCC		DSCR		Total	
	Items	Value	Items	Value	Items	Value
On time						
1-30	69	\$58.2	10	\$ 5.3	79	\$ 63.5
Overdue						
31-60	20	4.7	3	3.6	23	8.3
61-90	6	2.8	5	1.2	11	4.0
91-120	6	1.8	9	4.9	15	6.7
over 120	1	0.2	1	0.6	2	0.8
Unknown	17	5.7	104	90.3	121	96.0
<b>Total</b>	<b>119</b>	<b>\$73.4</b>	<b>132</b>	<b>\$105.9</b>	<b>251</b>	<b>\$179.3</b>

<sup>1</sup>Elapsed days from date of system notification of excess procurement to date of item manager decision.  
<sup>2</sup>Unknown refers to sample items that lacked documentation of processing timeliness.

**Tracking Timeliness.** DSCC and DSCR did not have a management system in place to track timeliness of reviews for notifications of excess procurement and to track termination actions resulting from those reviews. DSCC was in the process of completing enhancements to the Contract Administration Tracking System. That automated system, when fully functional, may provide the required capability to track timeliness of the review of excess procurement notices and link those reviews to excess procurement terminations executed by contracting officers. As of February 1998, the SAMMS-based automated termination model that produces the notices of excess procurement was the principal tool for ICPs to identify potentially excess procurements. However, DLA did not incorporate procedures and controls into the use of that automated termination model to ensure prompt and effective actions were taken to curtail procurements of unneeded materiel.

In the sample items that we reviewed, prompt action by ICPs in reviewing notices of excess procurement appeared to have a relationship to the success of terminating excess procurements. DSCC processed 69 out of 119 of its notices of excess procurement within 30 days, and DSCR processed 10 out of 132 within 30 days. The termination rate prior to the audit for DSCC was more than double that for DSCR. DSCC had terminated 18 out of 119 procurements with an additional 6 terminations as a result of on-site questions from the audit team. DSCR had terminated 7 out of 132 procurements and added

2 terminations as a result of the audit team's on-site work. Appendix D depicts detailed data on the termination status of the sample items reviewed at both DSCC and DSCR.

During the audit at DSCC, we identified an excess procurement of electron tubes (NSN 5960-00-411-1713) valued at \$270,000. The item manager reported that he had personally notified the contracting officer in May 1996 that termination of the contract was recommended. The contracting officer explained that the contract was not terminated because the contract file could not be located. A tracking system would have identified the disconnect between the request to terminate and a termination action, but without the tracking system, the excess procurement was not identified and terminated. DSCC took immediate action during our audit to establish control of its contract files by using a bar code system on all contract files. However, DSCC did not institute a formal tracking system.

### Procedures and Controls for Data and Termination Actions

DLA did not have procedures and controls to ensure the input of accurate data into termination models. As result, the DLA termination model used for preparing notices of excess procurement often provided invalid information on whether termination of unneeded materiel might be economical.

**Reliability of Database.** The SAMMS database was unreliable because item managers entered inappropriate and unsubstantiated data into the database. As a result, the analytic output from the termination model was not a reliable source on which to base termination decisions. The termination model was integrated as a subroutine into SAMMS. It was designed to be an analytical tool to assist the inventory manager in identifying excess procurements and calculating the consequences of terminating excess quantities on order. The termination model used SAMMS database information to identify demand, inventory on hand, inventory on order, lead times, prices per unit, procurement cycles, safety levels, and special program requirements. However, because of inaccurate and unreliable data in SAMMS, the model provided excess procurement data that were of questionable reliability for making decisions to terminate procurements of excess materiel.

**Customer Forecasts.** Customer forecasts were often inaccurate and lacked documentation as special program requirements (SPRs). DoD Regulation 4140.1-R requires that customer-forecasted requirements that are not based on demand data be submitted to the item manager as SPRs. DoD Components submitting SPRs are required to establish internal controls and maintain supporting documentation to ensure the appropriateness and accuracy of SPR submissions, correlate requisitions with related SPRs, and assure timely and accurate reporting of significant changes in requirements. Additionally, the requesting DoD Component is to ensure that investment in inventory to support SPRs is kept to a minimum.

Item managers used unsubstantiated data from informal customer forecasts not recorded or controlled as SPRs to justify increased quarterly forecasted demand and increased production lead-time quantities in the contract termination model. The unauthorized changes effectively changed an item manager's appropriate recommendation for terminating an excess procurement to an inappropriate recommendation for retaining the item. For example, a customer-generated forecast of annual demand for 176 jet engine oil manifolds (NSN 2945-01139-2283) was not validated and documented as an SPR. Consequently, the unsubstantiated annual demand for the manifolds that was entered into SAMMS exceeded the historical demand of 32 items per year by 144 items. The inflated customer demand resulted in a procurement for 421 items at a value of \$267,335 that exceeded requirements when compared to the historical demand. Our analysis showed that because the item manager bypassed the controls for entering valid data, SAMMS would not issue a notice of excess procurement for those 421 items and no termination action would be initiated.

### Consumable Items Transferred from Military Departments

DLA did not establish a uniform dollar threshold for reviewing consumable item transfers (CITs) from the Military Departments. Because of the large number of transactions with excess procurement and potential savings, DoD Regulation 4140.1-R requires a review of all purchase orders exceeding \$25,000 prior to contract award. A dollar threshold is not specified in DoD Regulation 4140.1-R for review of purchases after contract award. Each ICP, in conjunction with DLA, establishes a dollar threshold for review of purchases that are on an existing contract. DLA raised the review threshold for CITs recently transferred to DLA from the Military Departments primarily for two reasons. First, DSCC and DSCR reported that Navy and Air Force ICPs that had previously managed the items were unresponsive to requests for information required to support termination decisions. The DLA ICPs did not report any difficulties obtaining information from Army ICPs. Second, the actual contract administration for the on-order shipments remained a Military Department ICP responsibility and DLA did not have authority over the Military Department contracting officers to ensure contracts for excess procurements managed at DLA were canceled. Because the DLA ICPs had those procedural difficulties, which were time-consuming and often unproductive, DLA changed the review threshold from \$5,000 to \$50,000 for CITs at DSCC. The dollar threshold for review at DSCR was changed from \$10,000 to \$75,000 for CITs. There was no evidence that either DSCC or DSCR based the revised thresholds on an economic analysis of cost to perform the reviews versus the potential gain from canceling excess procurements.

We reviewed the total number of notices of excess procurement for the 10- and 11-month periods at DSCC and DSCR to identify the impact of the revised dollar thresholds. We determined how many additional notices of excess procurement would have been reviewed for potential savings if DSCC and DSCR had applied uniform thresholds to all items. If DSCC had followed the established dollar threshold for review of notices of excess procurements of potential savings in excess of \$5,000, an additional 4,711 notices would have

required review. The value of the additional review was estimated to be \$74.6 million. Following the established threshold of \$10,000 in potential savings at DSCR would have required the review of an additional 5,219 items with an estimated value of \$150 million. We believe that the potential for additional savings that could be identified and gained justifies a more aggressive pursuit of the review of all items that meet the established thresholds already in place at the ICPs.

## Management Emphasis on Terminations

DLA did not place sufficient management emphasis on preventing excess procurements. The DLA Corporate Plan,<sup>3</sup> undated, did not have a stated goal or performance indicator that measured progress in curbing excess procurements. The FY 1997 annual performance plans of the supply centers set goals for performance in critical indicators that were established from coordination between the ICPs and DLA. The DLA ICPs regularly briefed DLA management on the performance indicators contained in Supply Center Annual Performance Plans. Excess procurements and timely review of notices of excess procurement were not performance indicators in Supply Center Annual Performance Plans briefed to DLA management in FY 1997. During the course of the audit, DLA took action to establish overprocurement goals as an ICP performance measure for FY 1998.

**DLA Emphasis.** DLA management did not track trends in excess procurements. As a result of the Inspector General, DoD, Report No. 93-146, DLA attempted to gain oversight of terminations in June 1993 by establishing a monthly requirement for data on contract terminations at each ICP.<sup>4</sup> Specifically, DLA tasked ICPs to provide cancellation data to facilitate an accurate account of the effects of termination and cancellation actions of the inventory reduction program. DLA personnel reported that the database on cancellation actions was no longer maintained, although the requirement had not been formally canceled. DLA personnel also indicated that they did not plan on making the requirement an action item because the management philosophy had changed in the interim and management of ICPs was now a decentralized function.

Without the DLA reporting requirement for ICPs, item managers paid less attention to reviewing notices for excess procurements. For example, in December 1996, at DSCR, a product center supervisor disregarded the requirements in DoD Regulation 4140.1-R as well as local procedures<sup>5</sup> by suspending reviews of termination notices for all items in his product center. The product center supervisor stated that item managers did not have time to do

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<sup>3</sup>DLA did not have a strategic plan during the course of our audit. DLA documented its corporate strategy in the form of a Corporate Plan. The first DLA Strategic Plan was published in March 1998.

<sup>4</sup>DLA memorandum, "Terminations," June 21, 1993.

<sup>5</sup>The only documentation of local procedures was in the DSCR FY 1995 budget guidance.

the reviews of the termination model notices and, therefore, relied on the military item manager's judgment in requesting the purchase. He also noted that there was no incentive to prevent excess procurements because the purchases were made with Military Department funds instead of DLA funds. As a result, notices of excess procurement for the approximately 2,000 items handled by this particular product center were not reviewed for a period of approximately 9 months. However, reviews were resumed between the time of our initial visit to DSCR in August 1997 and the time of our return visit in October 1997.

**Requests for Information and Justifications.** Item managers at DSCC and DSCR did not provide sufficiently detailed justification for not terminating the procurement of 59 of 67 items we questioned in memorandums. Of 43 memorandums that we issued to DSCR personnel requesting information and justifications, only 2 led to the termination of excess procurements valued at about \$700,000. Many of the item manager justifications provided in response to our request for information were questionable because they were based on demand that was not properly documented.

For example, an item manager at DSCR recorded 2,188 units of stockage requirements for a jet engine part (NSN 2840-01-179-6811) as "other production lead time" in SAMMS. This requirement was based on an informal customer forecast rather than a formally documented SPR as required by DoD Regulation 4140.1-R. The action by the item manager to enter a requirement under the category of other production lead time resulted in the termination model specifying that the termination of any of the order would not be economical. As a result, the item manager had demand for 2,188 items rather than the 360 items that were supported by historical annual demand data. Improperly documented demand based on informal customer requirements for an additional 1,818 units resulted in a procurement for about \$3.8 million in excess materiel.

Out of 24 memorandums we issued to DSCC personnel, 6 led to termination of excess procurements totaling about \$1.7 million. The actions resulting from our memorandums requesting information and justification are summarized in Table 2. Of the \$47.1 million in potential terminations identified by our memorandums, \$44.7 million in purchases were not terminated. Since the conclusion of our on-site audit, DSCC and DSCR have reduced the amount of potentially excess procurement for the memorandum items to about \$34 million. The \$10.7 million reduction was the result of receipt of inventory rather than subsequent contract terminations.

<u>Action</u>	<u>DSCC</u>		<u>DSCR</u>		<u>Total</u>	
	<u>Items</u>	<u>Value</u>	<u>Items</u>	<u>Value</u>	<u>Items</u>	<u>Value</u>
Terminated	6	\$1.7	2	\$ 0.7	8	\$ 2.4
Not terminated	18	4.9	41	39.8	59	44.7
<b>Total</b>	<b>24</b>	<b>\$6.6</b>	<b>43</b>	<b>\$40.5</b>	<b>67</b>	<b>\$47.1</b>

## Conclusion

Reduction of DoD supply inventories by \$12 billion is a Government Performance and Results Act goal for DoD. DLA can contribute toward the DoD goal of inventory reduction by improving its management of terminations of excess procurements. With timely reviews of notices of excess procurement, DLA might still terminate excess procurements with potential monetary benefits up to \$34 million in addition to the \$2.4 million terminated during the audit. Actions taken by DLA to address this problem over the past several years have been ineffective.

## Recommendations, Management Comments, and Audit Response

**Deleted Finding, Renumbered Recommendations, and Revised Recommendation.** We deleted draft Finding B and its recommendations because the material control weakness is sufficiently addressed in Appendix A of the report and implementing the recommendations for the remaining finding should correct the weakness. Deleting draft report Finding B and its recommendations resulted in the renumbering of Recommendations A.1. and A.2. as 1. and 2., respectively. As a result of DLA comments to the draft report, we revised the renumbered Recommendation 2.e. to clarify our intent.

**1. We recommend that the Deputy Chief of Naval Operations (Logistics) and the Commander, U.S. Air Force Materiel Command, emphasize that:**

**a. Item managers provide the Defense Logistics Agency information on contract terminations concerning consumable items transferred to the Defense Logistics Agency for management.**

**b. Contracting officers execute timely contract terminations when recommended by the Defense Logistics Agency.**

**Navy Comments.** The Navy generally concurred, stating that its item managers provide information necessary for making termination decisions. However, it also stated that Military Departments are weapon system managers and DLA is a commodity manager. The Navy stated that the DLA inventory model does not recognize factors necessary for determining weapon system inventory projections. Consequently, if there is disagreement with DLA concerning an inventory level, the Navy inventory projections will take precedence.

**Audit Response.** The Navy comments were partially responsive. The Navy did not provide specific actions and completion dates to ensure that Navy item managers would be responsive to DLA requests for information and recommendations to terminate contracts for consumable items that were transferred to DLA for management. Therefore, we request the Navy provide additional comments in response to the final report.

**Air Force Comments.** The Air Force concurred, stating that business rules in DoD Regulation 4140.26-M provide instructions for both the gaining and losing organization personnel on proper coordination and timely execution of terminations. The Air Force stated it would send each Air Logistics Center a memorandum that reemphasizes the need to follow the rules in DoD Regulation 4140.26-M. The memorandum would specifically cite the requirement to respond to DLA in a timely manner on termination decisions. The Air Force stated it would send the memorandum by June 19, 1998.

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

**a. Develop procedures and controls to ensure that inventory control points perform timely review and tracking of termination actions at the item manager and contracting officer level.**

**DLA Comments.** DLA concurred, stating that this is addressed in its current milestones for closing the existing material control weakness in this area. The estimated completion date is August 1998.

**Audit Response.** The DLA comments were partially responsive. DLA reported timely processing of excess procurements as a material control weakness in its FY 1993 annual statement of assurance. The FY 1993 annual statement identified the target correction date as FY 1994 and provided planned milestones to achieve the necessary correction. Since 1993, DLA has revised the target correction date and associated milestones every year through FY 1997, but it has yet to correct the weakness. Consequently, we have limited assurance that the current DLA milestones for correcting the material control weakness will be met. Therefore, we request that DLA provide the specific actions that will be completed by September 30, 1998, in response to the final report.

**b. When appropriate, require that a customer-forecasted requirement be submitted as a Special Program Requirement in keeping with DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," January 25, 1993.**

**DLA Comments.** DLA concurred, stating that it sent a policy letter to Defense Supply Centers dated April 17, 1998.

**c. Make the dollar threshold for reviewing consumable item transfers consistent with the threshold established by inventory control points for reviewing all other categories of procurements.**

**DLA Comments.** DLA partially concurred, stating that the current policy was established in coordination with the DLA Defense Supply Centers and the Services. The thresholds for consumable items were established to provide the most cost-effective review process by the Services for contract terminations based on workload and available resources. DLA will assess the work load associated with the revised review thresholds; request Military Department concurrence with recommended changes; and, if feasible, implement the revised contract review thresholds. The estimated date of completion for the planned action is July 31, 1998.

**d. Include prompt resolution of notices of excess procurement as a performance indicator in Supply Center Annual Performance Plans as well as the Defense Logistics Agency Strategic Plan.**

**DLA Comments.** DLA partially concurred, stating that it evaluated supply center processes to develop strategies implementing the Supply Center Annual Performance Plans' overprocurement goals. The need for more intensive management was reflected in April 30, 1998, guidance to the centers. DLA is confident that the necessary improvements can be achieved through existing goals and strategies addressing process timeliness.

**Audit Response.** The DLA comments were partially responsive. DLA did not provide specific details on whether performance indicators were implemented in the April 30, 1998, guidance or in the Supply Center Annual Performance Plans' overprocurement goals. Therefore, we request that DLA clarify its position in response to the final report.

**e. Determine if notices of excess procurement for each of the 59 items identified during the audit were valid and terminate those items that were not terminated by Defense Supply Center Columbus and Defense Supply Center Richmond.**

**DLA Comments.** DLA partially concurred, stating that it initiated the review of 59 items to determine if the items were in true excess and processed in accordance with policy and procedural guidelines. DLA requested that the recommendation in the draft report be revised because the recommendation implied that the items in question were overprocured and not "potential" overprocurements. The estimated completion date for DLA to review the 59 items is June 1998. DLA did not comment on the \$34 million in potential monetary benefits related to the review and termination of the 59 items reported as excess.

**Audit Response.** Based on DLA comments, we revised the recommendation. We request DLA comment on the revised recommendation and the \$34 million in potential monetary benefits in response to the final report.



## **Part II - Additional Information**

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## Appendix A. Audit Process

### Scope

**Work Performed.** We performed the audit at DLA headquarters and two DLA ICPs: DSCC and DSCR. We reviewed documents dated from January 1993 through November 1997 that included:

- DoD regulations and DLA procedures and practices on materiel management;
- DoD policies, procedures, and practices for inventory reduction and the review and cancellation of procurements of excess materiel;
- due-in studies containing notices of excess procurement for a sample of 251 items, ICP item manager supply system studies, monthly ICP summary reports of excess procurements, and contract and purchase requests terminated;
- business rules for consumable item transfers;
- documents describing the contract termination model (Termination for Convenience Decision Support Model) used to prepare notices of excess procurement;
- budget execution plans at DSCC and DSCR that provided the criteria for review of potential savings identified in the notices of excess procurement; and
- DLA correspondence that authorized the review thresholds of potential dollar value cited in the budget execution plans.

We also obtained overviews of DSCC and DSCR efforts to automate the contract termination management process.

**Limitations to the Audit Scope.** The audit was limited to the review of due-in studies having notices of excess procurement at DSCC and DSCR. A subsequent audit will cover the same audit objectives at the two remaining DLA supply centers: Defense Industrial Supply Center Philadelphia and Defense Supply Center Philadelphia.

Our review of notices of excess procurement was limited to a judgmental sample of 119 items at DSCC and 132 items at DSCR. The sample group of 251 items was based on selecting the high dollar value items that could generate the largest potential savings at the two ICPs. The data at DSCC covered the 10-month time period, September 1996 through June 1997, and the data for DSCR covered the 11-month time period, September 1996 through July 1997.

Our review of the contract termination model was limited to descriptive documents and observing the results of the model on notices of excess procurement. We did not review the equations used by the model, nor did we review the programming for the model, which is described as a subroutine of SAMMS. Although we requested information on the equations and the programming used in the model during our audit, DLA was not able to provide the information. We did not review a second contract termination model, a personal computer application used by contracting officers to determine if actually terminating a contract order whose quantities have previously been identified as excess would be economical.

## Methodology

We reviewed DoD, DLA, DSCC, and DSCR policies and procedures for evaluating notices of excess procurement. We also interviewed personnel at DLA, DSCC, and DSCR regarding internal policies and procedures for managing excess procurements and terminating purchase requests and contracts. We performed an in-depth review of 251 notices of excess procurement at DSCC and DSCR. Our review also included interviews with item managers, contracting officers, and supervisors at the ICPs to clarify the data in the notices of excess procurement and to obtain supporting rationale for decisions to terminate or not terminate the procurements. As a method of verifying the data in the notices of excess procurement, we independently calculated the value of the stock objective using demand history, lead times, procurement cycles, and safety levels obtained from the termination model and the item manager. As a result of our independent verifications and the interviews with ICP personnel, we verified that 184 out of the total sample of 251 notices of excess procurement were not excess or had already been terminated. Criteria used for determining whether continuing a procurement action was justified or potentially excess was based on the requirements in DoD Regulation 4140.1-R. We issued a standard memorandum to the item managers and their supervisors for each of the remaining 67 NSNs that lacked justification for continued procurements. The memorandum requested additional information about the NSNs with potentially excess procurements. That information included the required stock objective; a determination of whether the quantities being procured were excessive; an explanation of why the procurement in question should or should not be terminated; and an explanation of the quantity terminated and the associated dollar savings. We reviewed the item manager responses to the memorandums to determine if sufficient documentation was provided to justify the continued procurement. Those NSNs for which item managers said actions had been initiated to terminate the procurements in question were categorized as terminated. Timeliness of review of notices of excess procurement was determined by comparing the date of the notice of excess procurement and date of the item manager's review. Finally, we performed a limited review of the SAMMS-based termination model and DLA preparations for year 2000 issues.

**DoD-Wide Corporate Level Government Performance and Results Act (GPRA) Goals.** In response to the GPRA, DoD established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal.

**Objective:** Fundamentally reengineer DoD and achieve 21st century infrastructure. **Goal:** Reduce costs while maintaining required military capabilities across all DoD mission areas. **(DoD-6)**

**National Performance Review Reinvention Impact Center Goal.** This report relates to achievement of the goal of reducing supply inventory by \$12 billion by the year 2000. **(ACQ-3.3)**

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

**Logistics Functional Area. Objective:** Streamline logistics infrastructure. **Goal:** Implement most successful business practices (resulting in reductions of minimally required inventory levels). **(LOG-3.1)**

**General Accounting Office High Risk Area.** The General Accounting Office has identified several high risk areas in DoD. This report provides coverage of the Defense Infrastructure and Defense Inventory Management high risk areas.

**Use of Computer-Processed Data.** To achieve the audit objective, we relied on computer-processed data from the termination model that is a subroutine of SAMMS to identify the universe of excess procurements. We determined the accuracy of the data during our interviews with item managers. Because we verified the accuracy of the data with item managers, inaccurate data did not materially affect our audit conclusions. We verified quantities on order, on hand, lead times, and forecasted demand. The item managers were responsible for maintaining the SAMMS database used by the termination model to determine excess procurements. Some items were entered more than once in the database as a potential excess procurement. For those duplicate entry items, we screened the database to eliminate all but the most recent entry based on the most recent termination model study. To the extent that we reviewed data from SAMMS, we concluded that the data were either accurate or that other evidence was sufficiently reliable to meet our audit objectives.

**Universe and Sample.** The universe of the potential excess procurements consisted of the notices of excess procurement provided by the SAMMS-based termination models at DSCC and DSCR. DSCC provided data on excess procurements from September 1996 through June 1997. DSCR provided data on excess procurements from September 1996 through July 1997. DSCC and DSCR together had 19,803 purchases in progress valued at about \$522 million for materiel that potentially exceeded requirements. From that universe, we

selected for review a group of 251 potential excess procurements that had the greatest dollar value. At DSCC, a group of the 119 highest dollar items were reviewed; at DSCR, the 132 highest dollar items were reviewed.

**Use of Technical Assistance.** The Technical Director and an operations research analyst from the Quantitative Methods Division, Office of the Assistant Inspector General for Auditing, DoD, assisted in reviewing the universe of items provided by DSCC and DSCR. The Quantitative Methods Division eliminated repeated items, retaining the more recent items for use in our review. The Quantitative Methods Division also reviewed documents on the termination model provided to us by the DLA.

**Audit Type, Dates, and Standards.** We performed this economy and efficiency audit from July 1997 through February 1998 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

**Contacts During the Audit.** We visited or contacted individuals and organizations within the DoD and the General Accounting Office. Further details are available on request.

## Management Control Program

DoD Directive 5010.38 requires 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 the controls.

**Scope of Review of Management Control Program.** We reviewed the adequacy of management controls in place at DLA, DSCC, and DSCR as they pertained to reviewing notices of excess procurement and terminating contracts and purchase requests.

**Adequacy of Management Controls.** The management controls at DLA, DSCC, and DSCR were not adequate in that notices of excess procurement were not promptly and adequately reviewed and contracts and purchase requests were not promptly terminated. As a result, the material weakness of untimely contract terminations disclosed in each annual statement of assurance since FY 1993 was not resolved. Implementation of the recommendations in the finding will resolve the material weakness and may result in up to \$34 million in potential monetary benefits in addition to the \$2.4 million realized during the course of the audit. A copy of the report for this audit will be provided to the senior officials responsible for management controls at DLA, DSCC, and DSCR.

**Adequacy of Management's Self-Evaluation.** DLA identified timeliness of contract terminations as an assessable unit. It was listed as a material weakness in the FY 1997 statement of assurance as well as each statement of assurance since FY 1993. Although progress in correcting the weakness was reported in each of the annual statements since FY 1993, DLA had not corrected the material weakness.

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## Appendix B. Summary of Prior Coverage

During the past 5 years, the Inspector General, DoD, and the audit organizations of the Military Departments issued four reports that discussed various elements of requirements determination and controls over potential contract terminations. We have summarized the reports below.

### Government Accounting Office

**General Accounting Office, Report No. GAO/NSIAD-98-86, OSD No. 1565, "Navy Inventory Management," April 30, 1998.** The report focused on excess inventory the Navy had on order. The report recommended that Congress may wish to consider requiring the Secretary of Defense to direct the Secretary of the Navy to issue guidance revising Navy computation process requirements to eliminate planned program requirements that are duplicated in reorder levels. The report states that purchases were not based on valid needs for 68 of 200 items reviewed, with \$13 million also included in the reorder level requirement, and therefore counted twice as requirements; were excess to needs because the requirements changed after orders were placed; and occurred even though contracts could have been canceled but were not because the Navy added "protection levels" representing as much as 2 years of usage. The report recommended that Navy improve the validity of requirements by updating demand forecasts in a timely manner; eliminate 1- and 2-year protection levels when considering purchases for cancellation; and reemphasizing to item managers that they have the responsibility to direct cancellation of contracts. DoD partially agreed with the report. DoD agreed that Navy demand forecasts should be updated. DoD also agreed that the Navy would reiterate contract termination policy with item managers. However, DoD did not agree to eliminate protection levels when considering contracts for termination.

### Inspector General, DoD

**Inspector General, DoD, Report No. 97-226, "Consumable Item Transfer, Phase II, Management," September 30, 1997.** This report was the second in a series of reports regarding the CITs, phase II. The report states that the Military Departments improperly retained management of consumable items that should have been transferred to DLA. As a result, duplicate management of consumable items was not reduced to the extent originally planned. In addition, the Military Departments did not provide a full pipeline of inventory assets to DLA when transferring phase II items. The report recommended that the Deputy Under Secretary of Defense (Logistics) direct the Military Departments to rescreen consumable items retained for management, transfer items appropriately, and justify the retention of items in accordance with the DoD policy. The report also recommended that the Military Departments establish controls to ensure that DLA is provided with full pipelines of assets for

consumable item transfers, phase II items; expedite contractual orders; and advise the DLA inventory control points of delays and cancellations of purchase requests. DoD concurred with the findings and recommendations.

**Inspector General, DoD, Report No. 93-146, "Contract Terminations at DoD Wholesale Inventory Control Activities," June 30, 1993.** The report states that internal controls were not established to pursue potential terminations of contracts for significant quantities of materiel that exceeded future requirements. The report recommended the establishment of specific criteria on determining the benefits of terminating unneeded materiel on contract and a corresponding revision in existing termination models. The report also recommended the development of controls over the evaluation of termination candidates and a system to track the timeliness of termination actions. The Military Departments and DLA generally concurred with the recommendations and DLA issued guidance to the ICPs.

## **Army Audit Agency**

**U.S. Army Audit Agency, Report No. AA 98-53, "Contract Termination Process, U.S. Army Communications-Electronics Command, Fort Monmouth, New Jersey," December 23, 1997.** The report discussed an audit of the U.S. Army Communications-Electronics Command's (the Command) contracting operations as they related to the termination of contracts. The report states that the Command's current acquisition policies and procedures provided its personnel with adequate guidance related to the termination of contracts. The Command's acquisition instructions outlined administrative policies and procedures for approving contracts for termination, executing no-cost settlement instead of termination, and processing contract modifications to release excess funds. The Command generally released excess funds timely from terminated contracts once it received instructions from termination contracting officers. As a result, the Army was able to reuse funds totaling about \$6.3 million and also returned about \$1.8 million to the Navy. However, the Command could have identified and released an additional \$4.8 million if its contracting officers had periodically reviewed the status of terminated contracts. The report recommended that the Command coordinate with the Defense Contract Management Command and the Defense Finance and Accounting Service for the release of funds from particular contracts. The Command agreed. In addition, the report recommended that the Command direct contracting personnel to periodically review terminated contracts to determine if excess funds can be released. The Command agreed and implemented the recommendation in a procurement acquisition letter.

## **Naval Audit Service**

**Naval Audit Service, Report No. 003-97, "Terminations of Contracts for Spare Parts at the Naval Inventory Control Points," October 15, 1996.** The report specifies that naval inventory control points did not identify and

deobligate \$40.1 million in unused funds related to terminated contracts, for the period ranging from 4 to 65 months after such action was required. The report identified other problems, such as insufficient guidance, lack of communication, and inaccurate databases, which led to weak management controls over the processing of terminations. The report recommended that naval inventory control points establish a system to strengthen controls over the contract termination process, to improve the reliability of the automated contract termination database, and to deobligate and recoup the unused funds identified by the report. The Navy concurred with all recommendations and took or planned satisfactory corrective actions.

## **Air Force Audit Agency**

**Air Force Audit Agency, Report No. 97425023, "Air Logistic Center Contract Termination," June 20, 1997.** The report was part of a centrally directed audit to evaluate the management of contract terminations at Air Logistics Centers. The report evaluated the justification used by the Warner Robins Air Logistics Center personnel for terminating excess items on order. The report states that Air Force Materiel Command personnel effectively terminated contracts for \$8.9 million in excess items. However, more timely validation of excess on-order items could have resulted in additional contract terminations for items totaling \$18.8 million. The report recommended that Warner Robins Air Logistics Center establish procedures to improve timeliness, ensure that all potential terminations are reviewed in a timely manner, and ensure that appropriate actions are taken. Management officials agreed with the recommendations.

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## Appendix C. Contract Termination Guidance

**Materiel Management Guidance.** DoD policy on contract terminations is contained in DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," January 25, 1993. This regulation states that ICPs will maintain appropriate records to ensure accountability of reduction decisions and the coordination of reduction decisions across functional areas. Reduction decisions are to be reached and implemented in a timely manner, normally within 30 days of generation of a notice of excess procurement. Item managers and contracting officers are primarily responsible for termination actions. Guidance requires that termination action shall be pursued if determined to be cost-effective and in the best interest of the Government. The regulation also states that, prior to contract award, item managers should place particular emphasis on validating requirements data used as the basis for orders exceeding \$25,000.

**Consumable Item Transfer Guidance.** Additional guidance for materiel management was established by business rules for CITs. Those business rules were established in response to the restructuring and consolidation of the Military Department materiel management functions under DLA. The rules specifically require that DLA not dispose of materiel transferred by the Military Departments until at least 2 years have passed from DLA assuming management of the item, unless the Military Department gives prior approval. The business rules precluding disposals do not prevent DLA from recommending that the Military Departments terminate excess procurements of CITs. In fact, the business rules require that DLA item managers ensure that all data, to include item manager folders and program-driven requirements information, have been considered prior to requesting cancellation or termination of any purchase request as a result of a notice of excess procurement.

**Item Manager Responsibilities.** The DLA automated materiel management system, SAMMS, provides the input for the model that generated notices of excess procurement to the item manager. The notices recommend the reduction of purchase request or contract quantities when requirements decrease and the quantities on hand and on order exceed the quantity authorized for stockage of a particular item. Item managers are required by DoD Regulation 4140.1-R to verify data used in the requirements computation to ensure that the automated system's identification of candidates for procurement reduction or total termination of an excessive quantity was appropriate. If assets on order after validation are excessive, the item manager is to recommend to the contracting officer reduction or cancellation of any excessive quantity that is on a purchase request in process. If materiel was on contract, the item manager is to determine whether termination of the excessive on-order assets would be economical.

According to the guidance in DoD Regulation 4140.1-R, cost-effectiveness, after contract award, should be determined by a comparison of what it will cost to hold items in inventory versus the cost to terminate the same items from contracts, plus reprourement costs, if known. If the item manager review of a

## Appendix C. Contract Termination Guidance

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notice of excess procurement determined that a termination action would be economical, the item manager is to request the contracting officer to consider terminating the excess quantity of materiel on contract.

**Contracting Officer Responsibilities.** DoD Regulation 4140.1-R requires that the contracting officer promptly reduce or cancel orders before contract award if requested by the item manager as a result of requirements analysis. After contract award, the contracting officer is to validate the cost-effectiveness of contract termination to ensure that cancellation is in the best interest of the Government. The Federal Acquisition Regulation, subpart 49.101, "Authorities and Responsibilities," requires that contracting officers terminate unneeded materiel from contracts when it is in the Government's best interest. The contract termination model that generates the notices of excess procurement was designed to assist in that determination. DoD Regulation 4140.1-R requires followup action on all requests for reduction or cancellation of contracts or purchase requests to ensure that award quantities reflect reductions in requirements.

## Appendix D. Excess Procurement Sample

<b>Status of Excess Procurement: DSCC and DSCR Sampled Items Only (dollars in millions)</b>						
<b>Action</b>	<b>DSCC</b>		<b>DSCR</b>		<b>Total</b>	
	<b>Items</b>	<b>Value</b>	<b>Items</b>	<b>Value</b>	<b>Items</b>	<b>Value</b>
<b>Before Audit</b>						
Not excess	77	\$61.5	82	\$62.7	159	\$124.2
Terminated	18	5.3	7	2.7	25	8.0
<b>Subtotal</b>	<b>95</b>	<b>\$66.8</b>	<b>89</b>	<b>\$ 65.4</b>	<b>184</b>	<b>\$132.2</b>
<b>During Audit<sup>1</sup></b>						
Terminated after Memorandum	6	\$ 1.7	2	\$ 0.7	8	\$ 2.4 <sup>2</sup>
<b>Subtotal Terminated</b>	<b>6</b>	<b>\$ 1.7</b>	<b>2</b>	<b>\$ 0.7</b>	<b>8</b>	<b>\$ 2.4</b>
<b>Not terminated</b>						
Contract officer	8	\$ 2.8	8	\$ 8.2	16	\$ 11.0
Item Manager	10	2.1	33	31.6	43	33.7
<b>Subtotal not Terminated</b>	<b>18</b>	<b>\$ 4.9</b>	<b>41</b>	<b>\$ 39.8</b>	<b>59</b>	<b>\$ 44.7</b>
<b>Total</b>	<b>119</b>	<b>\$73.4</b>	<b>132</b>	<b>\$105.9</b>	<b>251</b>	<b>\$179.3</b>

<sup>1</sup>Memorandums were issued to item managers requesting justification for procuring items that we could not determine were required.

<sup>2</sup>\$2.4 million represents actual savings gained during the audit.

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## **Appendix E. Report Distribution**

### **Office of the Secretary of Defense**

Under Secretary of Defense for Acquisition and Technology  
Deputy Under Secretary of Defense (Logistics)  
Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management)  
Director, Defense Logistics Studies Information Exchange  
Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Assistant Secretary of Defense (Public Affairs)

### **Department of the Army**

Assistant Secretary of the Army (Installations, Logistics, and Environment)  
Auditor General, Department of the Army  
Commander, U.S. Army Materiel Command

### **Department of the Navy**

Assistant Secretary of the Navy (Financial Management and Comptroller)  
Deputy Chief of Naval Operations (Logistics)  
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  
Commander, U.S. Air Force Materiel Command

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Finance and Accounting Service  
Director, Defense Logistics Agency  
Director, National Security Agency  
Inspector General, National Security Agency  
Inspector General, Defense Intelligence Agency

### **Non-Defense Federal Organizations and Individuals**

Office of Management and Budget  
General Accounting Office  
National Security and International Affairs Division  
Technical Information Center

**Non-Defense Federal Organizations and Individuals (cont'd)**

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations  
Senate Subcommittee on Defense, Committee on Appropriations  
Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
House Committee on Appropriations  
House Subcommittee on National Security, Committee on Appropriations  
House Committee on Government Reform and Oversight  
House Subcommittee on Government Management, Information, and Technology,  
Committee on Government Reform and Oversight  
House Subcommittee on National Security, International Affairs, and Criminal  
Justice, Committee on Government Reform and Oversight  
House Committee on National Security

## **Part III - Management Comments**

# Department of the Navy Comments

Final Report  
Reference



DEPARTMENT OF THE NAVY  
OFFICE OF THE ASSISTANT SECRETARY  
RESEARCH, DEVELOPMENT AND ACQUISITION  
1000 NAVY PENTAGON  
WASHINGTON DC 20350-1000

JUN 5 1998

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR  
GENERAL FOR AUDITING

SUBJECT: DEPARTMENT OF DEFENSE INSPECTOR GENERAL DRAFT  
AUDIT REPORT: CONTRACT TERMINATIONS AT DEFENSE  
SUPPLY CENTER COLUMBUS AND DEFENSE SUPPLY CENTER  
RICHMOND (Project No.7LD-3011)

REFERENCE: (a) DODIG Memorandum of March 27, 1998

ENCLOSURE: (1) Department of the Navy Response to Draft  
Audit Report

We have reviewed the findings and recommendations  
forwarded by reference (a). Detailed comments are provided  
in enclosure (1).

We concur with the report recommendation A.1. The  
Department of the Navy item managers do, and will continue  
to, provide necessary information to support termination  
decisions. However, if there is disagreement regarding the  
necessary inventory level, the Navy reserves the right to  
continue procurement action based upon Department of the  
Navy inventory projections.

A handwritten signature in cursive script, appearing to read "W. Schaefer".

WILLIAM J. SCHAEFER  
Deputy Assistant Secretary  
of the Navy  
Planning, Programming, and  
Resources

Copy to:  
CNO (N09BMR)  
CNO (N4J1)  
RDA (ABM)  
NAVSUP (91E)  
FMO (31)

Changed  
Recommendation  
A.1. to 1.

Department of the Navy Comments

Final Report  
Reference

DEPARTMENT OF THE NAVY RESPONSE  
TO  
DODIG DRAFT AUDIT REPORT OF MARCH 27, 1998  
ON  
CONTRACT TERMINATIONS AT DEFENSE SUPPLY CENTER COLUMBUS  
AND DEFENSE SUPPLY CENTER RICHMOND  
(Project No. 7LD-3011)

**Finding A: Excess Procurement Termination Process**  
Consumable Items Transferred from Military Departments:  
"First, DSCC and DSCR reported that Navy and Air Force ICPs that had previously managed the items were unresponsive to requests for information required to support termination decisions. ... Second, the actual contract administration for the on-order shipments remained a Military Department ICP responsibility and DLA did not have authority over the Military Department contracting officers to ensure contracts for excess procurements managed at DLA were canceled."

Finding A  
Header  
Deleted

**Recommendation A.1:** We recommend that the Deputy Chief of Naval Operation (Logistics) and the Commander, U.S. Air Force Materiel Command, emphasize that:

Changed  
Recommendation  
A.1. to 1.

a. Item managers provide Defense Logistic Agency information on contract terminations concerning consumable items transferred to the Defense Logistic Agency for management.

b. Contracting officers execute timely contract terminations when recommended by the Defense Logistics Agency.

**Department of the Navy Position:** Concur. Department of the Navy item managers do, and will continue to, provide DLA information necessary for making termination decisions. However, the Military Services are generally weapon system managers while DLA is a commodity manager. The DLA inventory model is primarily demand based and does not recognize factors necessary for determining weapon system inventory projections such as scheduled requirements, weapon system relationships, etc. Therefore, the DLA model is inclined to recommend an inventory level less than the Service model. If there is disagreement regarding the required inventory level, the Navy reserves the right to continue procurement action based upon Department of the Navy inventory projections.

Enclosure (1)

# Department of the Air Force Comments

Final Report  
Reference



DEPARTMENT OF THE AIR FORCE  
HEADQUARTERS UNITED STATES AIR FORCE

09 JUN 1998

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

FROM: AF/LS

SUBJECT: DoDIG Draft Report, Contract Terminations at Defense Supply Center Columbus  
and Defense Supply Center Richmond, (Project 7LD-3011)

This is in reply to your memorandum requesting the Air Force provide comments on  
subject report.

Both HQ AFMC and HQ USAF concur with the recommendation A1 regarding  
consumable assets transferred to the Defense Logistics Agency (DLA). This recommendation  
states HQ AFMC emphasize, to its inventory managers and contracting officers, the need to  
provide information on contract terminations, and to execute timely contract terminations when  
recommended by DLA.

Business rules exist in DoD 4140.26-M which provides instructions, for both the gaining  
and losing organization personnel, on proper coordination and timely execution of terminations.  
HQ AFMC will send each of the Air Logistics Centers a memorandum from the Director of  
Logistics which reemphasizes the need to follow the rules in the DoD 4140.26.M. The  
memorandum will specifically cite the requirement to respond to DLA in a timely manner on  
termination decisions. The memorandum will be sent no later than 19 Jun 98.

Our point of contact is Mr. John Calhoun, HQ USAF/ILSP, (703) 695-4895

*James T. Seebert*  
Acting Director of Supply  
DPS/Installations & Logistics

cc:  
HQ AFMC/LGIA (T. Frantz)  
SAF/FMPS (D. Sapp)

Changed  
Recommendation  
A.1. to 1.

# Defense Logistics Agency Comments



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

IN REPLY  
REFER TO

MAY 28 1998

DDAI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,  
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Contract Terminations at Defense Supply Center and Defense  
Supply Center Richmond, 7LD-3011

Enclosed are our comments to your request of 22 March 1998. Should you have any questions,  
please contact Annell Williams, 767-6274.

Encl

  
JEFFREY GOLDSTEIN  
Chief (Acting), Internal Review Office

cc:  
DLSC-LS  
DLSC-BO

## Defense Logistics Agency Comments

Final Report  
Reference

28 MAY 1998

**Subject:** Contract Terminations at Defense Supply Center Columbus and Defense Supply Center Richmond

Finding A  
Header Deleted

**Finding A:** DSCC and DSCR did not aggressively pursue potential terminations of contracts and purchase requests for materiel that exceeded requirements. Of 251 notices of excess procurement value at \$179.3 million, approximately \$36.4 million of potentially excess materiel on order had not been effectively reviewed and promptly processed over a 10 or 11 month period at the ICPs. The condition occurred because DLA did not institute procedures and controls that ensured the timely review and prompt processing of termination actions at DSCC and DSCR and the input of accurate data into internal termination models. Additionally, DLA did not establish uniform dollar thresholds to effectively manage consumable items transferred from the respective Military Departments, and Navy and Air Force ICPs did not provide the required information. Finally, DLA did not place sufficient management emphasis on contract terminations. The purchase of excess materiel resulted in lost opportunities to reduce the DoD inventory of secondary items, as well as lost opportunities to put funds to better use.

**DLA Comments:** Partially concur. While we concurred for the most part with the thrust of the Inspector General recommendations, there are some basic misperceptions that invalidate portions of the findings. This is especially true for the estimates of potential savings.

Changed  
Recommendation  
A.2.e to 2.e.  
on Page 13

This analysis, as did the prior IG report, identifies a flawed review process as the major contributor to the significant difference between the number/dollar amount of candidate overprocurements and the resulting, actual terminations. Our previous Materiel Management Reviews, and our analysis of the 59 IG selected items, (See Recommendation A.2.e., Page 12) indicate that the difference in the figures stems from the large number of extraneous candidates generated by the system. This situation results from erroneous or missing requirements or due-in data in the database. While the study recognizes that "because of inaccurate and unreliable data in SAMMS, the [termination] model provided excess procurement data that were of questionable reliability for making decisions to terminate procurements of excess materiel" (Page 7), the report does not place the same emphasis on this as a root problem as we do. Having admitted the data is inaccurate, the IG utilizes it to compute questionable but damaging dollar estimates of potential savings throughout the report.

Changed  
Recommendation  
A.2.c. to 2.c.

Because of this invalid or missing information, a manage-by-exception process to ferret out overprocurements becomes bogged down in a "data scrub" effort. This is most evident in the area of Consumable Item Transfer (CIT) candidates, which comprised a disproportionately high segment of the items analyzed. Because we have been unsuccessful in accurately transferring all due-in/requirements data mechanically, both the DLA Gaining and the MILSVC Losing Item Manager must resort to labor intensive manual work-arounds to compensate. (See Recommendation A.2.c., Page 12)

This manual validation also contributes significantly to untimely processing. While the DoD policy states that "[t]ermination decisions should generally be reached within 30 days of generation of a notification that items under contract should be considered for termination," this timeframe represents a real challenge given the current volume of extraneous outputs and the labor intensive effort to validate requirements and due-in data. Also, the competition this process has for resources with other critical management-by-exception situations directly related to warfighter support, must be recognized as an influence on timeliness. However, we are confident our increased management focus will result in reduced process time.

Our reviews did not substantiate widespread errors in management judgment implied by the report. More common were Inventory Manager (IM) failures to input valid requirements data that would have offset the due-in quantity and precluded an item from being a candidate for overprocurement in the first place. We see this as indicative of the need for additional training in some instances, or the result of the IMs "cutting corners" to cope with increased workloads, in others. Between FY 90 and FY 97, the number of items we manage increased by 33% while the end strength at the Supply Centers decreased by 25%.

The IG report did corroborate our previous Materiel Management Review findings that greater discipline was needed in defining customer requirements projections. We are continually working with the Military Services to improve the accuracy of the DoD Special Program Requirements (SPR) capability. (See response to Recommendation A.2.b.) When SPRs are not the appropriate vehicle, we have stressed the need to obtain written vice solely telephonic requirements from the customer. We have emphasized the need to enter the data in the system and maintain its currency to ensure accurate automated decision-making. We recognize these more formal, disciplined approaches lessen, but do not totally eliminate, the volatility in requirements projections. We have taken these measures to preclude investment in inapplicable inventory, while remaining focused on our primary mission to support the warfighter.

Through increased management emphasis and oversight, we are eliminating potential causes of overprocurement. Similarly, we are taking concerted steps to correct policy and procedural voids that detract from our potential overprocurement identification and contract termination process. This includes a major effort to increase the integrity of our database. We are confident these actions will remove any doubts, real or perceived, that DLA does not have an effective program for responding in a more timely manner to potential overprocurement situations.

**Internal Management Control Weakness:** Partially Concur; weakness is already reported in the DLA Annual Statement of Assurance.

Changed  
Recommendation  
A.2.b. to 2.b.

## Defense Logistics Agency Comments

Final Report  
Reference

Finding B  
Deleted

**Finding B:** DLA reported a management control weakness on untimely contract terminations at wholesale inventory control points that had gone uncorrected for more than 4 years. This condition occurred because the DLA management had not taken prompt action to issue joint guidance on the timely processing of excess procurements and had not made aggressive management of excess procurements a priority for DLA. In addition, DLA management had not issued guidance implementing DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996. As a result, DLA continued to make procurements that were excess to DoD needs.

**DLA Comments:** Concur. DLA has greatly increased the level of management visibility to ensure this deficiency is corrected in FY 98.

**Internal Management Control Weakness:** Concur; weakness is already reported in the DLA Annual Statement of Assurance.

### RECOMMENDATIONS:

A.1. DoD IG recommends that the Deputy Chief of Naval Operations (Logistics) and the Commander, U.S. Air Force Materiel Command, emphasize that:

- a. Item managers provide DLA information on contract terminations concerning consumable items transferred to DLA for management.
- b. Contracting officers execute timely contract terminations when recommended by DLA.

**DLA Comments:** Concur. We see this recommendation as related to Recommendation A.2.c. below. The resulting dialog will compensate for the IGs failure to discuss the impact of revised thresholds on the MILSVC end of the pipeline prior to their recommendation.

**Disposition:** N/A

A.2. DoD IG recommends that the Director, DLA:

- a. Develop procedures and controls to ensure that inventory control points perform timely review and tracking of terminations actions at the item manager and contracting officer level.

**DLA Comments:** Concur. This is addressed in our current milestones for closing the existing materiel weakness in this area.

**Disposition:** Action is ongoing. ECD: August 1998

Changed  
Recommendation  
A.1. to 1.

Changed  
Recommendation  
A.2.c. to 2.c.

Changed  
Recommendation  
A.2. to 2.

- b. When appropriate, require that a customer-forecasted requirement be submitted as a Special Program Requirement in keeping with DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," January 25, 1993.

**DLA Comments:** Concur. Policy letter sent to Defense Supply Centers, dated April 17, 1998.

**Disposition:** Action is considered complete.

- c. Make the dollar threshold for reviewing consumable item transfers consistent with the threshold established by inventory control points for reviewing all other categories of procurements.

**DLA Comments:** Partially concur

The current policy was established in coordination with the DLA Defense Supply Centers and the Military Services. A contract termination request by DLA generates the following actions by the Military Services:

- A. Requirements Validation: Determine if there are valid requirements for the item that did not pass to DLA and therefore were not considered in DLA's contract termination recommendation.
- B. Contract Termination: Request / negotiate contract termination with the contractor.

These two functions are labor intensive. Personnel resources to perform these functions must be diverted from other valid missions. The current review thresholds were chosen in concurrence with the MILSVCs as a balance between potential savings and associated workload.

Since the current policy was established, downsizing has reduced personnel resources at both DLA and the MILSVCs. DLA will assess the workload associated with the revised review thresholds. Additionally, DLA will request MILSVC concurrence with the recommended change. Upon concurrence by the MILSVCs, and if feasible within current resources, DLA will implement the revised contract termination review thresholds.

**Disposition:** Action is ongoing. ECD: July 31, 1998

## Defense Logistics Agency Comments

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- d. Include prompt resolution of notices of excess procurement as a performance indicator in Supply Center Annual Performance Plans as well as the Defense Logistics Agency Strategic Plan.

**DLA Comments:** Partially concur. In response to this recommendation, we evaluated Center processes to develop strategies implementing the Annual Performance Plan Overprocurement goals. The need for more intensive management was reflected in April 30, 1998 guidance to the Centers. We are confident we can achieve the necessary improvements through the existing goal and strategies addressing process timeliness.

**Disposition:** Action is ongoing. ECD: August 1998

- e. Determine if excess procurements should be terminated on each of the 59 items identified during the audit that were not terminated by Defense Supply Center Columbus and Defense Supply Center Richmond.

**DLA Comments:** Partially concur. We request this recommendation be revised. We have initiated the review of the 59 items to determine if the items were in true excess and processed in accordance with policy and procedural guidelines. We believe this was your intent. The current wordset perpetuates the basic misconception of "potential" overprocurement addressed in our comments on Finding A. As written, the recommendation implies the items were overprocured and asks us to "[d]etermine if excess procurements should be terminated..."

**Disposition:** Action is ongoing. ECD: June 1998

Revised  
Page 13

Finding B  
Deleted

B. DoD IG recommends that the Director, DLA:

1. Issue joint guidance for wholesale inventory control points on contract terminations.

**DLA Comments:** Concur. This is addressed in our current milestones for closing the existing materiel weakness in this area.

**Disposition:** Action is ongoing. ECD: June 1998

Deleted

2. Correct the recurring management control deficiency of untimely contract terminations.

**DLA Comments:** Concur.

**Disposition:** Action is ongoing. ECD: August 1998

3. Issue guidance implementing DoD Instruction 5010.40, "Management Control Program Procedures," August 28, 1996.

Deleted

**DLA Comments:** We agree with the DoDIG that "formal" DoD Instruction 5010.40, "Management Control Program Procedures," has not been provided to DLA components. We anticipate that this guidance will be disseminated to DLA's functional entities by June 30, 1998.

It should be noted that "informal guidance" which is in consonance with these procedures has been provided via agency-wide conferences, workshops, and similar forum.

**Disposition:** Action is ongoing. ECD: June 30, 1998

**Action Officers:** Robert Theiss, Diann Dailey, and John Alphin, DLSC-LS  
Pierson Kemp, FO

**Review/Approval:** W.B. Bergmann for S.R. Morgan, RADM, SC, USNR, Acting  
Executive Director, Logistics Management (DLSC-L)  
May 8, 1998

**Coordination:** Annell W. Williams, DDAI

**DLA APPROVAL:**



E.R. CHAMBERLIN  
Rear Admiral, SC, USN  
Deputy Director

4 8 MAY 1998



## **Audit Team Members**

This report was produced by the Readiness and Logistics Support Directorate,  
Office of the Assistant Inspector General for Auditing, DoD.

Shelton R. Young  
Raymond D. Kidd  
Tilghman A. Schraden  
Kathryn L. Palmer  
Carolyn R. Davis  
Joseph A. Powell  
Raymond L. Hopkins  
Kayode O. Bamgbade  
Stuart W. Josephs  
Anita M. Manuel

