
Excess Inventory

The Scenario

The auditor was performing a review of physical inventory controls at an agency. When reviewing the audit sample population, they noted an increase in the amount of excess property losses and missing inventory items reported within the past year. Further analysis of inventory records disclosed the following trends:

- Fewer items were recorded as received in inventory records when compared to the number of items recorded as returned excess property.
- Large amounts of returned excess inventory items were reported as missing.

The auditor noted that many of the items reported as returned were in new, unused, and excellent condition. Example inventory returns included computers, scanners, laboratory equipment, medical supplies, and military uniforms. Inquiry with inventory management disclosed that the agency did not maintain documentation to show whether the returned items were reutilized, transferred, sold or destroyed. Consequently, the auditor could not determine whether the missing items reflected bookkeeping errors or were caused by theft. Management stated that they did not perform reviews of excess property loss reports because they did not have personnel trained to complete the work.

The auditor also conducted a spot check of excess inventory items stored in the agency warehouse. This review disclosed many items with missing property labels and shipping documents, and labels and shipping documents that were illegible due to exposure to sun, wind, and rain. In addition, some of the items were marked with incorrect disposal condition codes such as repairable or scrap when they should have been labeled excellent. Auditor interviews with warehouse personnel disclosed that they did not receive formal training on Department of Defense disposal condition codes. Instead, they were instructed to independently read Department of Defense guidance on the subject. Because of the large number of disposal condition codes that were missing, illegible, or incorrect, it was not possible for the auditor to conduct a physical inventory reconciliation.

The auditor conducted separate interviews with inventory employees to determine why the inventory division's operating procedures were not followed. During one of the interviews, a senior employee admitted to assigning incorrect disposal codes to returned inventory items. For example, a computer that was returned and never used would be labeled as scrap or missing in inventory records. The employees involved in the scheme then sold the stolen items on popular Internet websites such as eBay and Craigslist.

General Comments / Lessons Learned. Auditors should be aware of the increasing use of the Internet as a way to dispose of stolen Government property and technology. Many Internet websites do not have policies and procedures designed to prevent these sales from occurring and Internet commerce is not closely monitored. In general, the

Government is made aware of improper sales of property or technology after the transactions have occurred. There is also the potential risk that stolen Government property and technology can be used to compromise the safety of civilians, service members, and other United States allies. The Department of Defense continues to face ongoing challenges with its ability to accurately account for, monitor, and report inventory amounts. Auditors should be aware that this problem is not limited to excess inventory reporting.

FRAUD INDICATORS

- **Analysis of inventory records discloses unusual patterns or trends that cannot be reasonably explained.**
- **Unreliable property inventory data.**
- **Missing property labels and shipping documents.**
- **Illegible labels and shipping documents caused by exposure to sun, wind, and rain.**
- **Inventory items marked with incorrect disposal condition codes such as repairable or scrap when they should be labeled excellent.**
- **Inadequate management oversight and physical inventory control.**
- **Inadequate training of personnel.**