Audit Report

OFFICE OF THE INSPECTOR GENERAL

CONTROLS OVER MATERIEL PROCURED FOR DIRECT VENDOR DELIVERY

Report No. 95-107 February 10, 1995

Department of Defense

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Acronyms

DLA	Defense Logistics Agency
DVD	Direct Vendor Delivery

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
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February 10, 1995

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

SUBJECT: Audit Report on Controls Over Materiel Procured for Direct Vendor Delivery (Report No. 95-107)

We are providing this report for your review and comments. It discusses the Military Departments' and Defense Logistics Agency's controls over materiel procured by wholesale supply organizations for direct vendor delivery to their customers. Comments on a draft of this report from the Army, the Navy, the Air Force, and the Defense Logistics Agency were considered in preparing this final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Comments from the Navy were responsive. However, we request that the Army, Air Force, and the Defense Logistics Agency provide additional comments on the recommendations. For details of specific response requirements, see the table at the end of the finding. All comments are requested by April 11, 1995.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. James Kornides, Audit Program Director, or Mr. Danzel Hickle, Audit Project Manager, in our Columbus Office at (614) 337-8009. Copies of the final report will be distributed to the organizations in Appendix D. The audit team members are listed on the inside back cover.

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Office of the Inspector General, DoD

Report No. 95-107 **February 10, 1995**
(Project No. 3LE-0032)

CONTROLS OVER MATERIEL PROCURED FOR DIRECT VENDOR DELIVERY

EXECUTIVE SUMMARY

Introduction. DoD wholesale supply organizations generally fill customer requirements with materiel shipped from DoD storage depots. If the materiel is a nonstocked item, not on hand, and not due in to fill a requirement, the wholesale supply organization can contract to have the materiel delivered directly to the customer from the vendor. The Military Departments did not separately identify and report the volume of wholesale sales using direct vendor deliveries. The Defense Logistics Agency's direct vendor deliveries for FY 1993 were $639.4 million, about 5 percent of its total sales.

Objective. The objective of the audit was to determine whether the internal controls over materiel procured by DoD wholesale management organizations for direct vendor delivery to customers were adequate and effectively implemented.

Audit Results. DoD did not have effective controls to detect and report undelivered materiel shipped direct from the vendor. As a result, we estimate that of the 416,668 direct vendor delivery transactions, valued at $1.4 billion, for materiel provided to DoD customers, 39,191 transactions had unconfirmed or indeterminable receipt, which increased the risk that undelivered or incomplete shipments could go undetected.

Internal Controls. Internal controls were not effective to ensure that materiel sent direct from vendors to customers was received. The weaknesses are material and allow increasing vulnerability as usage of direct vendor deliveries grows. See Part I for a description of the controls assessed and management's implementation of the DoD Internal Management Control Program and Part II for details on the weaknesses identified.

Potential Benefits of Audit. Improved controls over direct vendor deliveries will validate that all items ordered are delivered and reduce vulnerability to loss and fraud. However, we could not quantify the potential monetary benefits.

Summary of Recommendation. We recommend that the Military Departments and the Defense Logistics Agency ensure that records are adequate for due-in and receipt, discrepancies are reported, and customers acknowledge receipt for materiel.

Management Comments. The Army neither concurred nor nonconcurred with the finding and recommendations and stated that current procedures over direct vendor deliveries are adequate.

The Navy concurred with the finding and recommendations and will release a message to all major claimants and fleet activities emphasizing the importance of recording and reporting receipt of direct vendor deliveries along with reporting discrepancies in materiel received.

The Air Force concurred with the finding and recommendations and will take action to emphasize the importance of maintaining adequate records, and the prompt reporting of receipt, or lack thereof, on all direct vendor deliveries.

The Defense Logistics Agency partially concurred with the finding but not with the recommendations. However the Defense Logistics Agency stated that it would verify customer receipt for direct vendor deliveries and stress to its customers the importance of reporting receipt of materiel. See Part II for a discussion of managements' comments and Part IV for the complete text of the comments.

Audit Response. We request that the Army reconsider its position and comment on this final report. We consider the Navy's comments responsive. We request that the Air Force identify specific actions to be taken on the recommendations and provide the planned completion dates. The Defense Logistics Agency's planned actions meet the intent of the recommendations. However, we further request that the Defense Logistics Agency provide the dates for completion of planned actions. All comments are requested by April 11, 1995.

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

Part I - Introduction

Background

The Military Departments and Defense agencies (that is, customers) submit requisitions for materiel to the established DoD supply system. DoD Manual 4000.25-1-M, "Military Standard Requisitioning and Issue Procedures (MILSTRIP)," May 1987, provides the procedures for the customer to requisition materiel and requires each supply source (retail and wholesale supply organization) to establish and monitor customer requisition files. Requisitions that the retail supply organization can not fill are elevated to the wholesale supply organization for action. If the requisitioned materiel is a nonstocked item, is not in stock, and not due in to fill a requirement, the wholesale supply organization can contract with the vendor to have the requisitioned materiel delivered directly to the customer. Direct vendor delivery (DVD) is the normal means of supply for some materiel in the Federal Supply System.

When a vendor ships materiel directly to a customer, the wholesale supply organization should be advised of the shipment and should in turn advise the customer of the shipment. If the customer does not receive the shipment or if the quantity received differs from that expected, the customer is required to report the discrepancy to a designated office in the DoD Component. The designated office uses reports of discrepancy to identify problems in the supply system, and acts to preclude recurrence and to prevent overpayment to the vendor.

The Military Departments' wholesale supply organizations did not separately identify and report DVDs as part of their $9.5 billion gross sales for FY 1992. However, the Defense Logistics Agency (DLA) recorded DVDs of $310 million (2.5 percent) of the $12.0 billion in FY 1992 gross sales, and $639.4 million (5 percent) of the $11.9 billion in FY 1993 gross sales.

Objective

The objective of the audit was to determine whether the internal controls over materiel procured by DoD wholesale management organizations for DVDs to customers were adequate and effectively implemented.

Scope and Methodology

We reviewed and evaluated the procedures and controls in effect over DVDs at organizations of the Army, Navy, Air Force, Marine Corps, and DLA. To derive the audit universe, we extracted information on DVD transactions from computer files provided by the Military Departments and DLA that the wholesale supply organizations showed as completed (closed) during the 12 months preceding June 1993. We also extracted information on those DVDs still open and on file at the wholesale supply organizations when the Military Departments and DLA generated the computer files in June 1993. We used a stratified statistical sample of 1,934 transactions, valued at $224.2 million, selected from 416,668 DVD transactions, valued at $1.4 billion, obtained from the Military Departments' and the DLA records. We did not evaluate the validity of computer-processed data obtained from DVD customers because of the numerous types of systems involved. We did evaluate for accuracy a judgment sample of the Military Departments' and the DLA records. Generally, the data were accurate in identifying DVDs.

Our Quantitative Methods Division assisted in selecting and analyzing our statistical sample. The details on the sampling plan are in Appendix A.

To accomplish our audit objective, we visited or contacted about 300 customer organizations, 15 wholesale supply organizations, and 4 payment organizations to review available corresponding receiving documents, transaction registers, records of accountability, reports of discrepancy, and payment records that relate to our statistical sample of DVDs. We also visited or contacted 29 contractors and 15 contract administration offices to review available corresponding records from FY 1990 to the date of our visit or contact in FY 1994 for shipments and receipts applicable to some sample DVDs.

We attempted to confirm the receipt of a statistical sample of DVD shipments for the period covered by the audit universe using available corresponding receiving reports and transaction registers from FY 1990 to the date of our visit or contact made from August 30, 1993, to April 22, 1994, at the customer organization. In some cases we reviewed the transportation documents from appropriate transportation offices. We considered the materiel adequately accounted for if it were posted to appropriate property records.

This economy and efficiency audit was made from March 4, 1993, through July 8, 1994. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD. Accordingly, we included tests of internal controls as were considered necessary. Appendix C lists the organizations visited or contacted during the audit.

Internal Controls

Controls Assessed. We evaluated written policies, procedures, management reports and plans, as well as prior audit findings on internal controls and the DoD Internal Management Control Program related to DVDs. We assessed the adequacy of the internal controls at the customer organizations to detect nonreceipt of DVD shipments and to take corrective action, as needed. We also evaluated the internal controls over DVDs at the wholesale supply organizations.

Internal Control Weaknesses. The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Internal controls were not effective to detect nonreceipt of materiel shipped directly from the vendor to DoD customers and to ensure prompt corrective action. Specifically, due-in records were not maintained, reports of discrepancy were not processed, and required receipt confirmation transactions were not generated. The details are provided in Part II of this report.

DoD Internal Management Control Program. The Military Departments and DLA did not consider the controls over DVDs to be a separate assessable unit under the DoD Internal Management Control Program for FY 1993. The Army and the Navy did report uncorrected material accountability and control weaknesses from 1989. Although not specifically directed at DVDs, the uncorrected material weaknesses could relate to DVDs. The Army reported that on-hand assets were not always recorded. The Army expects to correct the accountability problem in FY 1994. The Navy reported that controls over initial spares shipped from contractors to storage and user organizations were inadequate. The Navy expects to complete actions to correct the receipt confirmation weakness by FY 1995.

The recommendations in this report, if implemented, will correct the material internal control weaknesses we identified. We could not quantify any potential monetary benefits from implementing the recommendations. A copy of this report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense, the Military Departments, DLA, and the Defense Finance and Accounting Service.

Prior Audits and Other Reviews

Inspector General, DoD, Report No. 89-114, "Control Over Spares for New Weapons Systems," September 22, 1989, concluded that the Navy was not

maintaining adequate control over initial spares shipped from contractors. Navy controls did not ensure that materiel paid for was received or that receipt of the materiel was entered in the accountable records of the customer. The report recommended that the Navy require receiving organizations to acknowledge receipt of materiel and process receipts to the accountable records, and that the hardware systems commands establish a system for followup on shipments where receipt is not acknowledged. The Navy concurred with the report recommendations and planned actions to improve the internal controls. We did not follow up on the Navy's actions because of the difference in scope between our audit and the prior audit recommendations.

Other Matters of Interest

DoD potential for paying for undelivered materiel is increasing because DVDs are being used more. The DoD wholesale supply system's use of DVDs is increasing because of DoD initiatives to cut costs and reduce on-hand inventory. The Defense Management Review and the May 1990 Inventory Reduction Plan announced by the then Under Secretary of Defense (Acquisition), presently the Under Secretary of Defense (Acquisition and Technology), included direct delivery initiatives as a means of reducing costs. DoD views DVDs as a way to avoid storage costs. Although the wholesale supply organizations incur processing and contracting costs for a customer's request that is filled through DVD, DVDs can be more economical and more responsive than putting high-demand commercial items in a warehouse, only to turn around and ship them to the customer. DLA is using DVD as part of its overall inventory reduction program. From FY 1992 through FY 1993, the DLA sales through DVD increased by more than 100 percent.

Part II - Finding and Recommendations

Detection of Undelivered Materiel

The Military Departments and Defense Logistics Agency did not have effective controls to detect and report undelivered materiel sent directly from vendors to DoD customers. The condition occurred because:

o DoD customers did not establish and maintain adequate records for materiel they were to receive;

o customers closed due-in records without either receiving the materiel or confirming with the wholesale supply organization that the materiel would not be sent;

o customers did not report receipt discrepancies, as required by DoD guidance; and

o customers did not acknowledge receipt of materiel to the wholesale supply organization.

As a result, we estimated that of 416,668 transactions, valued at $1.4 billion, for materiel provided to DoD customers, 39,191 transactions had unconfirmed or indeterminable receipt, which increased the risk that undelivered or incomplete shipments could go undetected and increased the vulnerability to fraud.

Background

DoD needs controls to ensure actual receipt of DVD shipments because the Defense Finance and Accounting Service may pay the vendor before the shipment is delivered. The Defense Finance and Accounting Service makes payments for DVDs based on receipt of an invoice from the vendor and satisfactory contract performance. If the contract requires source acceptance and inspection, payment is based on appropriate authorization by Government representatives accepting the materiel before shipment. If the contract requires destination acceptance, payment should not made until the materiel is delivered and accepted at destination. When the vendor ships the materiel, the contract administration office advises the wholesale supply organization of the shipment. The wholesale supply organization then advises the customer of the shipment. If receipt acknowledgment is not received, the Defense Finance and Accounting Service will generally assume receipt to make payment of a vendor invoice in accordance with the Prompt Payment Act.

DoD Manual 4000.25-7-M, "Military Standard Billing System," January 1985, provides for billing the customer for DVDs when the wholesale supply organization is notified that a Government representative has accepted the materiel before shipment or when the customer has acknowledged receipt of the materiel. If receipt acknowledgment is not received, the DoD wholesale supply organizations generally assume that DVD shipments have been received if the customer does not report a discrepancy. Detection of undelivered materiel depends on the customers' reporting individual discrepancies to, and requesting a billing adjustment from, the wholesale supply organization, using procedures in DoD Manual 4000.25-7-M.

Shipping Discrepancies. Joint Regulation (Army Regulation 735-11-2, Secretary of the Navy Instruction 4355.18, Air Force Regulation 400-54, and DLA Regulation 4140.55), "Reporting of Item and Packaging Discrepancies," December 6, 1991, requires the customer to report a shipping discrepancy. The customer submits the shipping discrepancy report to an action organization (for example, wholesale supply organization, contract administration office or packaging control point) when delivery is not made or when shortages are noted. The discrepancy report provides the basic information for claims against vendors and feedback for management evaluation of discrepancies. For DVDs, the customer must report any nonreceipt (including shortages) regardless of the value.

Transportation Discrepancies. Joint Regulation (Army Regulation 55-38, Naval Supply Instruction 4610.33C, Air Force Regulation 75-18, Marine Corps Order P4610.19D, and DLA Regulation 4500.15) "Reporting of Transportation Discrepancies in Shipment," May 1, 1982, requires customers to report transportation discrepancies to an action organization. The customer is required to submit a transportation discrepancy report to the wholesale supply organization and the contract administration office when there is a variation in quantity or condition of materiel received from that shown in the bill of lading or Government transportation document, or if materiel is delivered without documentation.

Receipt Acknowledgment. DoD Regulation 4140.1-R, "DoD Materiel Management Regulation," January 23, 1993, requires visibility of assets on order from time of requisition to receipt. The regulation requires receipt acknowledgment from the customers for all shipments resulting from the requisition process. DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures (MILSTRAP)," May 1987, contains detailed procedures for acknowledging receipt of materiel. The customer submits a materiel receipt acknowledgment document to the Defense Automatic Addressing System Office to report receipt of the shipment. Some exceptions exist to this reporting requirement, primarily for Navy ships without a mechanized supply system. The DoD materiel movement and issue standards

set in DoD Regulation 4140.1-R require most materiel shipped from vendors to be received and recorded on the customers' accountable records within 60 days of the date of shipment.

Detection Controls

The Military Departments and DLA did not have effective controls to detect and report undelivered materiel. Based on our stratified sample, we projected there would be 30,318 wholesale supply organization transactions, out of a universe of 416,668 transactions, for which the customer records could not confirm receipt and for which no discrepancy would be reported. An additional 8,873 transactions would be unassessable due to inadequate records. The estimated value of the unconfirmed transactions is $60.5 million, and the estimated value of the indeterminable transactions is $43.6 million.

In analyzing the audit sample, we also noted the following specific problems. For 124 transactions, valued at $7.4 million, of the 1,934 DVD transactions we reviewed, we could not confirm the customers' receipt for all or part of the quantity shipped, and the customers did not report the possible or actual discrepancy. Generally, the customers' records on the unconfirmed transactions did not provide enough evidence to conclusively determine whether the materiel had been received; and the customers did not identify and report any undelivered materiel. Based on wholesale supply organization records and in some cases, Defense Finance and Accounting Service records, the materiel was shipped. However, for 71 transactions the customers' records did not document actual receipt, for 23 transactions the customers closed their due-ins without receiving the materiel, and for 30 transactions the customers said they had not received all or part of the materiel shipped but did not report the discrepancy. We could not determine the status of 76 other transactions, valued at $6.8 million, because of missing information from the customers and at wholesale supply organizations.

Of the 124 unconfirmed receipt transactions, DoD made payment to the vendors for 98 transactions, valued at $4.7 million. The customers, wholesale supply organizations, and the applicable payment offices could not provide documentation to prove receipt of the materiel. We could not confirm that DoD paid for the remaining 26 transactions, primarily because we could not find, and the wholesale supply organizations could not provide, the data we needed to trace the transactions to the financial records.

Documentation and Recordkeeping. Of the 124 unconfirmed receipt transactions, the materiel had been shipped, but we could not locate, and the customer could not provide, records documenting actual receipt for

71 transactions, valued at $4.4 million. Additionally, for 76 other transactions that we classified as indeterminable, the wholesale supply organization and customer records were inadequate for us to form any opinion on what had happened. The customer could have canceled, administratively closed, or never established a due-in for the transaction. Without a due-in record, the customer would not have a basis to identify and report undelivered DVDs.

Inadequate documentation can effectively hide fraud and can increase risk associated with DVDs. Past audit reports and investigations have shown that some vendors have received payment and yet not delivered the materiel they had contracted to supply to DoD. From August 1, 1993, through July 31, 1994, the Inspector General, DoD, Office of the Assistant Inspector General for Investigations, opened 17 investigative cases for undelivered products.

Administratively Closing Due-in Records. For 23 of the 124 unconfirmed receipt transactions reviewed, valued at $2.6 million, the customers had closed their due-in records without receiving the materiel or a notice that the materiel would not be sent. For example, personnel at an Air Force organization told us they had canceled four of our sample transactions, valued at $104,163. They said they had submitted a request to the wholesale supply organization to cancel the transactions and received no response to the original cancellation request or to three follow-up messages on the original cancellation request. Because they received no response to their requests, they closed the four due-in records. Customer personnel told us they had no record of receiving the materiel; however, the wholesale supply organization records showed that the materiel had been shipped. Without a due-in record, the customer would not have a basis for reporting undelivered DVDs. The Defense Finance and Accounting Service confirmed that DoD paid the vendor for the materiel.

Reporting of Discrepancies. For 30 of the 124 unconfirmed receipt transactions, procedures and controls were not adequate to ensure detection and reporting of discrepancies. Normally, the wholesale supply organization sends a notice of shipment and a bill to the customer. The notice of shipment and the billing of the customer are regarded as safeguards to ensure that undelivered materiel is detected. The customer is expected to report the nonreceipt of materiel because the customer will want a billing credit for undelivered materiel. Passive controls were inadequate to detect undelivered DVDs. Customers did not always get notices of shipment to detect undelivered materiel and to report any nonreceipt of shipment.

Notice of Shipment. For 13 of the 30 transactions without a report of discrepancy, the customers either had not received the notice of shipment or had not posted the notice to their records. To detect undelivered materiel, the customers must have on record a notice that the quantity of materiel has been shipped to them. From the records available, we could not determine whether the notice of shipment was sent to the customer. The customers did not know

the quantity of materiel shipped to them; consequently they did not report a discrepancy for any undelivered DVDs. For example, a Navy wholesale supply organization did not provide notice of shipment to the customer on a valve (national stock number 4810-01-205-0363), valued at $17,411. According to the vendor's invoice, the valve was shipped from California to Mississippi on June 30, 1993, and paid for by the Defense Finance and Accounting Service. As of September 22, 1993, the customer had not received a notice that the valve had been shipped, had not received the valve, and had not reported the shipping discrepancy.

Partial or Nonreceipt of Shipments. For all or part of the quantity on 17 of the 30 transactions without a report of discrepancy, valued at $234,000, the customer did not comply with discrepancy reporting criteria applicable to DVDs. Customer records documented that materiel was partially received or not received; yet, the due-in records were closed and the identified discrepancies were not reported. The Joint Regulations on reporting of shipping and transportation discrepancies require that all discrepancies from DVDs be reported. Air Force personnel, however, did not file a report of discrepancy for a shortage of 70 feet of aluminum structural angle (national stock number 9540-00-931-7261), valued at $518. Instead, the Air Force absorbed the shortage as an inventory loss. Cognizant personnel at customer organizations, for 15 of the 17 transactions with shortages, agreed that they did not follow existing reporting procedures. For the remaining two transactions, receiving personnel told us that they had misinterpreted the joint regulation and had not reported the discrepancy because the shortage was under $250.

Acknowledgment of Receipt. Customers did not comply with controls for materiel receipt acknowledgment. For 106 of the 124 unconfirmed receipt transactions, the wholesale supply organization did not have, or could not provide, the customers' materiel receipt acknowledgment transaction. Without the customer receipt acknowledgment, the wholesale supply organization did not have complete information on the DVD to monitor and ensure receipt of materiel before the supply organization closed its records.

DoD customers do not confirm receipt of materiel on more than half of the shipment transactions processed through the Defense Automatic Addressing System Office. While DVDs are a small portion of the shipments processed through the Defense Automatic Addressing System Office, the overall receipt confirmation statistics are an indication of widespread noncompliance. Reports from the Defense Automatic Addressing System Office for the quarters ending September 30 and December 31, 1993, showed that 62.7 percent and 52.8 percent of the shipments, respectively, were delinquent. Customers had not acknowledged receipt of the materiel within 90 days after shipment. Usually the customers should receive shipments within 60 days of shipment, based on the standards in the DoD materiel movement and issue priority system.

Pending Management Actions

The problems identified in this report were reported in four General Accounting Office and Inspector General, DoD, reports issued from 1984 through 1988. See Appendix B for a summary of each report. The reports showed that:

o internal controls in the Military Departments and DLA did not ensure that materiel paid for was received,

o controls were not established to ensure receipt of materiel sent directly from contractor plants to overseas locations,

o customers did not always receive materiel and materiel that was not received usually was not reported, and

o shipment notices that DLA issued were frequently inaccurate and often late, which could delay the detection of undelivered materiel.

The Military Departments and DLA have planned actions to correct the problems. They are expanding the Military Standard Transaction Reporting and Accounting Procedures and the Military Standard Requisitioning and Issue Procedures to change receipt acknowledgment procedures. The Military Departments and DLA also plan to expand materiel receipt acknowledgment at all levels of supply. DoD has approved and plans to start test implementation of the procedures with the Marine Corps in FY 1997.

Under a 1990 approved change to the Military Standard Requisitioning and Issue Procedures and the Military Standard Transaction Reporting and Accounting Procedures, DoD will also revise procedures and controls to ensure that DVD materiel that is paid for is actually received. The revised procedures will:

o require customer organizations to establish due-in records for expected materiel from wholesale supply organizations including DVDs;

o require that wholesale supply organizations monitor customer receipt acknowledgment, to ensure that customers receive and account for materiel;

o require that the shipment status is provided to the customer designated to receive the materiel, to ensure that the customer is aware of the shipment;

o require the customer to acknowledge receipt of the materiel and require management to monitor the effectiveness of the receipt acknowledgment process; and

o require that receipt of the materiel is documented for fast pay and source acceptance contracts.

We talked to cognizant personnel at the Defense Logistics Standard Office and the Joint Logistics System Center on the implementation of the expanded materiel receipt acknowledgment procedures. They said that the changes would be incorporated as part of the DoD standard stock control system; but they could not give us a date for full implementation within DoD.

Summary

The exception-based controls and passive controls for detecting undelivered materiel through reported discrepancies are not adequate for DVDs, because the customers have not maintained adequate records, reported discrepancies, and acknowledged receipt of materiel. Implementation of the expanded receipt acknowledgment procedures should correct the weaknesses noted in our audit and would lead to reduced risk of fraud and waste and the loss of DoD materiel. However, we believe that interim action is needed because of the delay in full implementation.

Recommendations, Management Comments, and Audit Response

We recommend that the Army Deputy Chief of Staff for Logistics; the Commander, Naval Supply Systems Command; the Air Force Deputy Chief of Staff for Logistics; and the Director, Defense Logistics Agency, establish internal controls to ensure that DoD customers:

1. Establish and maintain adequate due-in and receipt records for direct vendor deliveries.

2. Report all receipt discrepancies for direct vendor delivery materiel.

3. Promptly acknowledge receipt of direct vendor deliveries using the established Military Standard Transaction Reporting and Accounting Procedures.

Army Comments. The Army neither concurred nor nonconcurred with the finding and recommendations and stated that current procedures are adequate to maintain due-in and receipt records for DVDs. It stated that current Army regulations and procedures ensure that shipment status information for DVDs are provided to its customers for reconciliation and action when materiel is not received. The Army will continue its efforts to improve service to its customers by expanding the use of DVDs using state-of-the-art automation. The Army indicated that it will send a memorandum and an instructional pamphlet to all of its inventory control points requesting items to be included in the expanded use of DVDs.

Navy Comments. The Navy concurred with the finding and recommendations. It will release a message to all major claimants and fleet activities to emphasize existing requirements to maintain adequate records for DVDs, to report discrepancies, and to direct the inclusion of due-in and receipt processing for materiel as an assessable unit in their internal management control program. The Navy will also provide to its activities detailed procedures for reporting receipt of vendor deliveries. Completion is expected by February 28, 1995.

Air Force Comments. The Air Force concurred with the finding and recommendations and stated that action would be taken to emphasize the importance of maintaining adequate records, and the prompt reporting of receipt, or lack thereof, on all DVD materiel. Completion is expected by January 30, 1995.

Defense Logistics Agency Comments. The DLA partially concurred with the finding but nonconcurred with the recommendations. In response to the finding, DLA stated that it would perform verification on 100 percent of customer receipts for all DVD orders issued above the small purchase threshold and a statistical sample of vendor delivery orders selected from small purchases. DLA also stated that it would, in coordination with the Deputy Under Secretary of Defense for Logistics, stress to the Services the importance of materiel receipt acknowledgment as an internal control. In response to the recommendations, it stated that current regulations and procedures provide the information necessary for its customers to report discrepancies and receipt of materiel. DLA suggested that an exception to the moratorium on changes to the Military Standard Requisitioning and Issue Procedures be obtained to implement approved changes that would require shipment status to all customers and receipt acknowledgment from all customers.

Copies of managements' comments are in Part IV of this report.

Audit Response. We do not consider the Army's comments to be responsive. The existing Army controls do not ensure that customers have adequate records of expected deliveries, report receipt discrepancies, and promptly acknowledge receipt of materiel.

The Army's plan to expand the use of automation on DVDs is a positive step. However, we continue to believe that action is necessary to improve controls over the receipt and reporting of DVDs. We request that the Army reconsider its position and provide comments to the recommendations in response to this final report.

The Air Force did not provide specific information on actions planned; therefore, we request that the Air Force provide specific actions to be taken and the planned completion dates for those actions.

We disagree with the DLA comments that current regulations and procedures provide the information necessary for its customers to report discrepancies and receipt of materiel. Those procedures have not been completely effective. However, the DLA planned actions, to perform verification of customer receipts for DVD orders, and to stress to the Services the importance of materiel receipt acknowledgment, satisfy the intent of our recommendations. We request that DLA provide the estimated dates for the completion of its planned actions. We believe that lifting the moratorium on changes to the Military Standard Requisitioning and Issue Procedures would not be practical. The moratorium was put in place to allow for the development of the Stock Control System and to prevent the transfer of resources before completion of development. We believe that the DLA planned actions to verify receipts will be sufficient to correct the existing deficiencies until development of the new system is complete.

Management Comments Required

Management is requested to comment on the items indicated with an X in the following table.

Management Comments Required on the Finding

Recommendation Number	Organization	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
1.	Army	X	X	X	IC
	Air Force		X	X	IC
	DLA			X	IC
2.	Army	X	X	X	IC
	Air Force		X	X	IC
	DLA			X	IC
3.	Army	X	X	X	IC
	Air Force		X	X	IC
	DLA			X	IC

* IC=internal control weaknesses

Part III - Additional Information

Appendix A. Sampling Plan and Results

Plan

The Army, the Navy, the Air Force, and DLA provided us computer tapes containing DVD transaction data from their respective logistics systems. The transaction data included transactions closed during the prior year and transactions remaining open in June 1993 when the data were extracted from various logistics systems. To derive the universe we purified the data by excluding transactions to which we could not assign a postal zip code, transactions for less than $1 million aggregate value that were assigned a ZIP code, and transactions that were for shipments to be delivered to organizations outside the United States and the Virgin Islands. The universe sizes and values for DVDs are in Table A.1.

Table A.1. Derived DVD Universe

Organization	Number of Transactions	Value (million)
Army	42,755	$ 358.0
Navy	12,642	65.6
Air Force	11,925	504.1
DLA	349,346	515.3
Total	416,668	$1,443.0

We reviewed Army records as of June 1, 1993; Navy records as of June 12, 1993, for Ships Parts Control Center and June 26, 1993, for Aviation Supply Office; Air Force records as of June 3, 1993; and DLA records as of June 5, 1993, for the Defense Construction Supply Center, Defense Electronic Supply Center, Defense General Supply Center, and the Defense Industrial Supply Center and June 7, 1993, for the Defense Personnel Supply Center.

We selected DVD transactions primarily by dollar value and location of customer. The customers were identified by postal zip code, and the values of the transactions within the same zip code grouping (first three digits of zip code) were summarized. We selected for review those three-digit zip code groupings that accounted for the larger aggregate values. In each of the zip code groupings selected, we stratified the transactions and selected a statistical sample to provide representation of the various types of DoD requisitions and customers

that DVD filled. Based on initial audit results, we determined that more than 30 percent of the Navy transactions were for transactions dated before 1991, and generally, the customers' records did not go back that far. Because of the large number of pre-1991 transactions in the Navy file, we revised the Navy universe of 20,505 transactions, valued at $153.4 million, excluding 7,863 pre-1991 transactions, valued at $87.9 million, and selected replacement transactions. The sample sizes and values for DVD transactions reviewed are in Table A.2.

Table A.2. DVDs Reviewed

Organization	Number of Transactions	Value (million)
Army	400	$105.3
Navy	405	13.5
Air Force	489	67.0
DLA	640	38.4
Total	1,934	$224.2

Results

The statistical projections for numbers and dollars of DVD transactions in various conditions of receipt are shown in Tables A.3. and A.4.

Table A.3. Projections on Receipt Status for the Number of DVD Transactions
(90-percent confidence level)

Audit Opinion	Estimated Transactions	Relative Number Precision*
Received/due-in	374,004	+/- 116,591
Canceled	2,602	+/- 2,442
Unconfirmed receipt	30,318	+/- 19,398
Indeterminable	8,873	+/- 10,592
Total	415,797	+/- 118,692
Unconfirmed receipt/ indeterminable	39,191	+/- 22,101

* Relative number precision is the range within which the estimated transactions for the given characteristic in the population will fall at the stated confidence level.

Table A.4. Projections on Receipt Status for the Value of DVD Transactions
(90-percent confidence level)

Audit Opinion	Estimated Value (million)	Relative Value Precision* (million)
Received/due-in	$1,253.6	+/- $ 92.7
Canceled	79.6	+/- 18.4
Unconfirmed receipt	60.5	+/- 53.0
Indeterminable	43.6	+/- 36.8
Total	$1,437.3	+/- $114.5
Unconfirmed receipt/ indeterminable	$ 104.1	+/- $ 64.5

* Relative value precision is the range within which the estimated value for the given characteristic in the population will fall at the stated confidence level.

In addition to the above projections, results from the statistical sample were used as judgmental results in the finding.

Appendix B. Summary of Prior Audits and Other Reviews

This appendix describes four audit reports issued by the General Accounting Office and the Inspector General, DoD, from 1984 through 1988. The reports identified problems that could also apply to DVDs and resulted in the DoD plan to expand the materiel receipt acknowledgment procedures.

General Accounting Office/NSIAD Report No. 88-179 (OSD Case No. 7599), "Receipt Confirmation Problems," July 14, 1988, reported that receipt could not be confirmed on 19 percent of the shipments analyzed. Prompt receipt confirmation and followup on overdue shipments is particularly important when DoD makes payments to vendors before the materiel is received. However, the internal controls in the Military Departments and DLA did not ensure that materiel paid for was received at storage activities. The report recommended that the Military Departments and DLA:

o comply with existing DoD guidance regarding intransit shipments to wholesale storage organizations,

o establish and reemphasize follow-up procedures on shipments that have been paid for but not received, and

o establish routine reconciliation procedures for supply and financial records to ensure that materiel that is paid for is actually received.

DoD concurred with the findings and recommendations and provided information on actions taken or planned to correct problems and implement recommendations.

Inspector General, DoD, Report No. 88-137, "Shipment Performance Notices Issued by the Defense Logistics Agency," April 19, 1988, reported that 24 percent of the shipment performance notices issued by the Defense Contract Administration Service, DLA, had at least one discrepancy. Shipment performance notices were frequently inaccurate and often late, which could result in delayed detection of a late shipment. The report recommended that the Director, DLA:

o modify the systems used by the Defense Contract Administration Service to annotate estimated dates of shipment;

o develop and issue instructions to ensure that correct addresses are used;

o monitor timeliness of contractor submission of shipping documents, and target consistently late contractors for remedial action; and

o report shipment performance notices as a material weakness in the annual statement on management controls.

DLA concurred with the finding and the recommendation. DLA agreed to issue instructions and modify the automated system to accomplish the recommendations.

General Accounting Office/NSIAD Report No. 88-113 (OSD Case No. 7482), "Controls Over Expedited Payments to Defense Suppliers Need Improvement," February 29, 1988, reported that the controls established by two DLA purchasing offices were not adequate. As a result, the Government paid for some items it did not receive. One purchasing office had not established an effective procedure to collect a possible $7 million from vendors for items previously identified as having been paid for but not received, or rejected and returned to the vendor. In other cases, it took months for overpayments to be discovered and refunded. Further controls were not established to ensure receipt of materiel sent directly from contractors' plants to overseas locations. The report recommended that the Director, DLA:

o conform to provisions of Office of Management and Budget Circular A-125, "Prompt Pay," August 1982;

o establish internal controls to ensure that receiving reports are matched to payment records for DVDs to overseas customers and problem vendors do not receive fast pay contracts;

o require the Commander, Defense Personnel Support Center, to collect outstanding claims against contractors for materiel paid for but not received; and

o identify fast pay procedures as a material weakness in the FY 1988 internal controls annual assessment.

DoD generally agreed with the findings and recommendations and noted action taken or planned to correct problems and implement the recommendations. While DoD concurred with the intent of the recommendations, DoD stated that the existing report of discrepancy system provided a cost-effective tool for ensuring that inadequate performance by fast pay contractors was brought to the attention of purchasing offices.

Inspector General, DoD, Report No. 85-050, "Report on the Audit of Control Over Shipments of Materiel From Department of Defense Depots," November 14, 1984, stated that DoD did not have adequate control over

5 percent of the materiel shipped from DoD depots. Customers did not always receive materiel, and materiel that was not received was usually not reported. In 3 percent of the cases, materiel was received but not recorded, and in 1 percent of the cases the customers' records were not adequate to determine whether materiel was received. The report recommended that:

o monitoring receipts be made an internal control responsibility of DoD organizations;

o better reporting of discrepant transactions be required;

o specific completion dates be established for current DoD initiatives; and

o improved enforcement of applicable regulations regarding control of shipments be required by the Military Departments.

DoD generally agreed with the finding and recommendations and noted action taken or planned to correct problems and implement the recommendations. DoD planned to issue system changes and additional guidance to accomplish the recommendations.

Appendix C. Organizations Visited or Contacted

Office of the Secretary of Defense

Deputy Under Secretary of Defense (Logistics), Supply Management Policy, Washington, DC
Joint Special Operations Command, Fort Bragg, NC

Department of the Army

Headquarters, Deputy Chief of Staff (Logistics), Supply Policy, Washington, DC
Army National Guard, Washington, DC
United States Army Armament, Chemical, Acquisition and Logistics Activity, Rock Island, IL
United States Army Aviation Troop Support Command, St. Louis, MO
United States Army Communications - Electronics Command, Fort Monmouth, NJ
United States Army Forces Command, Atlanta, GA
United States Army Materiel Command, Alexandria, VA
United States Army Materiel Command - Logistics Support Activity, Huntsville, AL
United States Army Missile Command, Huntsville, AL
United States Army Special Operations Command, Fort Bragg, NC
United States Army Tank-Automotive Command, Warren, MI
Headquarters, Aberdeen Proving Ground, Aberdeen, MD
Headquarters, Fort Gillem, GA
Headquarters, Fort Lee, Petersburg, VA
Headquarters, Fort Riley, KS
Headquarters, National Guard Bureau, Washington, DC
Headquarters, United States Army Corps of Engineers, Washington, DC
Headquarters, XVIII Airborne Corps, Fort Bragg, NC
Letterkenny Army Depot, Chambersburg, PA
Lexington Blue Grass Army Depot, Richmond, KY
Red River Army Depot, Texarkana, TX
Seneca Army Depot, Seneca, NY
Tobyhanna Army Depot, Tobyhanna, PA
Tooele Army Depot, Tooele, UT
Army National Guard, Fargo, ND
Army National Guard, Rapid City, SD
Army National Guard, United States Property and Fiscal Office - Alabama, Montgomery, AL
Army National Guard, United States Property and Fiscal Office - Arkansas, Little Rock, AR

Department of the Army (cont'd)

Army National Guard, United States Property and Fiscal Office - Georgia, Atlanta, GA
Army National Guard, United States Property and Fiscal Office - Connecticut, Hartford, CT
Army National Guard, United States Property and Fiscal Office - Kansas, Topeka, KS
Army National Guard, United States Property and Fiscal Office - Missouri, Jefferson City, MO
Army National Guard, United States Property and Fiscal Office - North Carolina, Raleigh, NC
Army National Guard, United States Property and Fiscal Office - Utah, Draper, UT
All Source Analysis System Field Office, Joint Tactical Fusion Program, Killeen, TX
Crane Army Ammunition Activity, Crane, IN
Hawthorne Army Ammunition Plant, Hawthorne, NV
McAlester Army Ammunition Plant, McAlester, OK
Picatinny Arsenal, Dover, NJ
Pine Bluff Arsenal, Pine Bluff, AR
United States Army Maintenance Activity, Fort Gillem, GA
United States Army Maintenance Support Activity, Windsor Locks, CT
Kimbrough Army Hospital, Fort Meade, MD
Tripler Army Medical Center, HI
United States Army Medical Department Activity, Fort Meade, MD
Walter Reed Army Medical Center, Washington, DC
Army National Guard, Company A, 560th Engineer Battalion, Dawson, GA
Army National Guard, Company B, 121st Infantry Battalion, Albany, GA
Army National Guard, Company D, 560th Engineer Battalion, Bainbridge, GA
Army National Guard, Company E, 121st Infantry Battalion, Tifton, GA
Joint Tactical Fusion Program, McLean, VA
Military District of Washington, Cameron Station, VA
Schofield Barracks, HI
United States Army Aviation Support Activity, Fort Meade, MD
United States Army Engineering Activity, Capital Area, Cameron Station, VA
United States Army Institute of Heraldry, Cameron Station, VA
United States Army Publications and Printing Command, Alexandria, VA
United States Army Reserve Center, St. Louis, MO
United States Army III Corps, Fort Hood, Killeen, TX
Yuma Proving Grounds, Yuma, AZ
12th Special Forces, Arlington Heights, IL
142nd Engineering Battalion, Fargo, ND
257th Army Band, Washington, DC

Department of the Army (cont'd)

367 Engineering Battalion, Fargo, ND
464 Transportation Medical Boat Company, Fort Belvoir, VA

Department of the Navy

Naval Air Systems Command, Crystal City, VA
Naval Sea Systems Command, Arlington, VA
Naval Security Group Command, Washington, DC
Naval Supply Systems Command, Crystal City, VA
Space and Naval Warfare Systems Command, Crystal City, VA
Maintenance and Logistics Command, Coast Guard Island, Alameda, CA
Assault Craft Unit Five, Camp Pendleton, CA
Fleet Materiel Support Office, Mechanicsburg, PA
Fleet Training Center, Norfolk Naval Station, Norfolk, VA
Fleet Training Group, San Diego, CA
Naval Air Facility, Andrews Air Force Base, MD
Naval Air Station-Alameda, Alameda, CA
Naval Air Station-Barber Point, Barbers Point, HI
Naval Air Station-Cecil Field, Cecil Field, FL
Naval Air Station-Jacksonville, Jacksonville, FL
Naval Air Station-Marietta, Marietta, GA
Naval Air Station-Miramar, San Diego, CA
Naval Air Station-North Island, North Island, CA
Naval Air Station-Pensacola, Episcopal, FL
Naval Air Warfare Center, China Lake, CA
Naval Amphibious Base, Corona, CA
Naval Aviation Supply Office, Philadelphia, PA
Naval Aviation Depot-Alameda, Alameda, CA
Naval Aviation Depot-Cherry Point, Cherry Point, NC
Naval Aviation Depot-Jacksonville, Jacksonville, FL
Naval Aviation Depot-Pensacola, Episcopal, FL
Naval Aviation Depot-San Diego, CA
Naval Base, San Diego, CA
Naval Command, Control, and Ocean Surveillance Center, Vallejo, CA
Naval Construction Battalion Center, Gulfport, MS
Naval Electronic Systems Security Engineering Center, Washington, DC
Naval Electronic Systems Engineering Center, San Diego, CA
Naval Fleet Hospital, Alameda, CA
Naval Hospital-Balboa, San Diego, CA
Naval Hospital, Camp Lejeune, NC
Naval Hospital, Camp Pendleton, CA
Naval Hospital, Jacksonville, FL
Naval Hospital, Episcopal, FL

Department of the Navy (cont'd)

Naval Ocean Processing Facility, Ford Island, Pearl Harbor, HI
Naval Ordinance Station, Alameda, CA
Naval Ordinance Station, Louisville, KY
Naval Research Laboratory, Washington, DC
Naval Reserve Center, Fargo, ND
Naval Security Group Activity, Pearl Harbor, HI
Naval Ship Systems Engineering Station, Philadelphia, PA
Naval Shipyard-Mare Island, Vallejo, CA
Naval Shipyard-Pascagoula, Pascagoula, MS
Naval Shipyard-Pearl Harbor, HI
Naval Station-Mayport, Mayport, FL
Naval Submarine Base, San Diego, CA
Naval Submarine Base, Pearl Harbor, HI
Naval Support Activity, Blendon Pleasant, United Kingdom
Naval Supply Center, Jacksonville, FL
Naval Supply Center, Oakland, CA
Naval Supply Center, San Diego, CA
Naval Supply Center, Pearl Harbor, HI
Naval Surface Warfare Center, Crane, IN
Naval Surface Warfare Center, Dahlgren, VA
Naval Training Center, San Diego, CA
Naval Weapons Station, Concord, CA
Naval Weapons Station, Seal Beach, CA
Navy and Marine Corps Reserve Center, Alameda, CA
Navy Public Works Center, Naval Base, San Diego, CA
Navy Public Works Center, Pearl Harbor, HI
Services School Command, San Diego, CA
Ship Intermediate Maintenance Activity, Mayport, FL
Ship Intermediate Maintenance Activity, Pearl Harbor, HI
Ship Intermediate Maintenance Activity, San Diego, CA
Ships Parts Control Center, Mechanicsburg, PA
Supervisor of Shipbuilding, Conversion and Repair, Naval Station, San Diego, CA

Department of the Air Force

Headquarters, Deputy Chief of Staff (Logistics and Engineering), Supply Policy, Washington, DC
Headquarters, Air Force Materiel Command, Wright-Patterson Air Force Base, Dayton, OH
Air National Guard, Biloxi, MS
Air National Guard, Dobbins Air Force Base, GA
Air National Guard, East Granby, CT
Air National Guard, Fargo, ND

Department of the Air Force (cont'd)

Air National Guard, Hickam Air Force Base, HI
Air National Guard, Jacksonville, FL
Air Force Medical Logistics Office, Fort Worth, TX
Andrews Air Force Base, MD
Barksdale Air Force Base, Shreveport, LA
Bolling Air Force Base, Washington, DC
Edwards Air Force Base, CA
Elgin Air Force Base, Valpariso, FL
Ellsworth Air Force Base, Rapid City, SD
Hickam Air Force Base, HI
Hill Air Force Base, Ogden, UT
Hurlburt Field, Hurlburt Field, FL
Keesler Air Force Base, Biloxi, MS
Kelly Air Force Base, San Antonio, TX
Luke Air Force Base, Glendale, AZ
McClellon Air Force Base, Sacramento, CA
Nellis Air Force Base, Las Vegas, NV
Ogden Air Logistics Center, Ogden, UT
Oklahoma City Air Logistics Center, Tinker Air Force Base, OK
Ramstein Air Force Base, Ramstein, Germany
Randolph Air Force Base, San Antonio, TX
Robins Air Force Base, Warner Robins, GA
Seymour Johnson Air Force Base, Kinston, NC
Travis Air Force Base, CA
Wright-Patterson Air Force Base, Dayton, OH

U.S. Marine Corps

Headquarters, Supply Policy, Washington, DC
Marine Corps Systems Command, Quantico, VA
Marine Corps Forces Atlantic, Norfolk, VA
Camp Lejeune, NC
Camp Pendleton, CA
Marine Corps Air Station, Camp Pendleton,CA
Marine Corps Air Station, Cherry Point, NC
Marine Corps Air Station, Kaneohe Bay, Oahu, HI
Marine Corps Air Station, Yuma, AZ
Marine Corps Base, Blount Island, FL
Marine Corps Liaison Office, United States Army Tank-Automotive Command, Warren, MI
Marine Corps Logistics Base, Albany, GA
Marine Corps Recruit Depot, San Diego, CA

U.S. Marine Corps (cont'd)

2nd Marine Air Wing, Cherry Point, NC
2nd Marine Air Wing, New River, NC

Defense Finance and Accounting Service

Headquarters, Defense Finance and Accounting Service, Arlington, VA
Defense Finance and Accounting Service, Albuquerque, NM
Defense Finance and Accounting Service, Columbus, OH
Defense Finance and Accounting Service, Tinker Air Force Base, OK
Defense Finance and Accounting Service, Wright-Patterson Air Force Base, Dayton, OH

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Automatic Addressing System Office, Dayton, OH
Defense Contract Management Area Operations, Buffalo, NY
Defense Contract Management Area Operations, Clearwater, FL
Defense Contract Management Area Operations, Dayton, OH
Defense Contract Management Area Operations, Garden City, NY
Defense Contract Management Area Operations, Indianapolis, IN
Defense Contract Management Area Operations, Orlando, FL
Defense Contract Management Area Operations, Ottawa, Ontario, Canada
Defense Contract Management Area Operations, Phoenix, AZ
Defense Contract Management Area Operations, Pittsburgh, PA
Defense Contract Management Area Operations, South Bend, IN
Defense Contract Management Area Operations, St Louis, MO
Defense Contract Management Area Operations, Syracuse, NY
Defense Contract Management Area Operations, Santa Ana, CA
Defense Contract Management Area Operations, United Kingdom
Defense Contract Management Area Operations, Valencia, CA
Defense Distribution Depot, Anniston, AL
Defense Distribution Depot, Ogden, UT
Defense Distribution Depot, Richmond, VA
Defense Distribution Depot, Texarkana, TX
Defense Construction Supply Center, Columbus, OH
Defense Electronics Supply Center, Dayton, OH
Defense General Supply Center, Richmond, VA
Defense Industrial Supply Center, Philadelphia, PA
Defense Personnel Supply Center, Philadelphia, PA

Other Federal Organizations

Army and Air Force Exchange Service, Washington, DC
Defense Contract Audit Agency, Cameron Station, VA
Defense Intelligence Agency, Huntsville, AL
Defense Information Systems Agency, Joint Interoperability Test Center, Washington, DC
Defense Mapping Agency Hydrographic and Topographic Center, Washington, DC
Defense Supply Service-Washington, Washington, DC
Federal Prison Industries, Bastrop, TX
General Services Administration, Washington, DC
General Services Administration, Kansas City, MO
National Aeronautics and Space Administration, Dryden Flight Research Center, CA
National Aeronautics and Space Administration, Inspector General, Washington, DC
National Security Agency, Fort Meade, MD
U.S. Soldiers and Airmen's Home, Washington, DC
White House Communications, Washington, DC

Contractors

AM General Corporation, South Bend, IN
Airtronics, Inc., Tucson, AZ
Dresser-Rand Company, Painted Creek, NY
E-L Products Company, East Aurora, NY
FT Services, United States Ordnance Test Station, China Lake, CA
General Dynamics Electronics, San Diego, CA
Greenfield Manufacturing Company, Inc., Philadelphia, PA
Hamilton Support Systems, East Windsor, CT
Harvard Industries, Elastic Stop Nut Division, Union, NJ
Hughes Missile Systems Group, Tucson, AZ
Kaman Aerospace Corp., Bloomfield, CT
Knolls Atomic Power Laboratory, Windsor, CT
Litton Poly-Scientific, Blacksburg, VA
Lockheed Sanders Corporation, Nashua, NH
Loral Corporation, Las Vegas. NV
McDonnell Douglas Corp., St. Louis, MO
Mar-Con Tool, Dayton, OH
Milan Box Corp., Milan, TN
National Steel and Ship Building, San Diego, CA
Northern Telecom, Inc., Atlanta, GA
Olympus America, Inc., Lake Success, NY
Raytheon Company Missile Systems Division, Richmond, KY
Raytheon Service Company, Annapolis Junction, MD
Rockwell Air Force Plant, Palmdale, CA
Southwest Truck Body, West Plains, MO

Contractors (cont'd)

Suntrand Turbomach, San Diego, CA
Turtle Mt. Manufacturing Company, Belcourt, ND
VSE Corporation, Alexandria, VA
VRG - Group Company, Chicago, IL

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Under Secretary of Defense for Logistics
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Secretary of the Army
Auditor General, Department of the Army

Department of the Navy

Secretary of the Navy
Assistant Secretary of the Navy (Financial Management)
Auditor General, Department of the Navy

Department of the Air Force

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

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

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

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on National Security, Committee on Appropriations
- House 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 IV - Management Comments

Department of the Army Comments

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

DALO-SMP

18 JAN 1995

MEMORANDUM THRU

DEPUTY CHIEF OF STAFF FOR LOGISTICS

DIRECTOR OF THE ARMY STAFF

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

FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (AUDITING)

SUBJECT: Audit Report on Controls Over Materiel Procured for Direct Vendor Delivery (Project No. 3LE-0032)--INFORMATION MEMORANDUM

1. This is in response to HQ, USAAA memorandum of 8 November 1994 (Tab A), which asked ODCSLOG to respond to your memorandum of 1 November 1994 (Encl to Tab A). Your memorandum requested that ODCSLOG review and comment on the recommendations.

2. Subject draft report recommends that internal controls be established to ensure that customers:

a. Establish and maintain adequate due-in and receipt records for direct vendor deliveries (DVDs).

b. Report all receipt discrepancies for DVD materiel.

c. Promptly acknowledge receipt of DVDs using established Military Standard Transaction Reporting and Accounting Procedures.

3. Current Army procedures are adequate to maintain due-in and receipt records for DVDs. Current regulations and procedures (AR 710-2, DA Pam 710-2-1, and DA Pam 710-2-2) ensure that customers are provided with status informing them that their requirement will be met through DVD. In addition, Army contracts that authorize DVD require the contractor to process an AS1 transaction to inform the customer that the materiel has been shipped. This transaction allows the customer to complete his responsibilities for reconciliation through the Standard Army Validation and Reconciliation program. AR 725-50 specifies policies to be used when materiel is not received.

DALO-SMP
SUBJECT: Audit Report on Controls Over Materiel Procured for Direct Vendor Delivery (Project No. 3LE-0032)--INFORMATION MEMORANDUM

4. However, in our continuing efforts to improve service to our customers, we are expanding our use of Just In Time (JIT)/DVD initiatives which interface with Electronic Data Interchange (EDI). Utilizing state-of-the-art automation, JIT/DVD and EDI receive and convert requisitions for items directly into purchase orders that are then transceived to the contractor for fulfillment of the requirement. The customer's requirement is electronically acknowledged. The contractor's invoice at time of shipment not only serves as a billing notice but also notifies the customer and Inventory Control Point (ICP) that shipment has been made. This new process will improve customer service by ensuring a higher percentage of quality reconciliations and producing significant time savings.

5. Expansion of the JIT/DVD and EDI program within the Army will be pursued this fiscal year. AMC is sending a memorandum and instructional pamphlet to all ICPs requesting items for inclusion in JIT/DVD and EDI, as well as milestones for implementation. We look forward to informing you of our success with expansion of this effort.

Encl

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

CF:
VCSA
CDR, AMC
SAIG-PA
DALO-ZXA
AMCLG-SR
AMCIR-A

AMCLG-SR - Concur, Ms. Tuck/274-8671 (by phone)

Mrs. Hensley/57785

2

Department of the Navy Comments

THE ASSISTANT SECRETARY OF THE NAVY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

DEC 29 1994

MEMORANDUM FOR THE DEPARTMENT OF DEFENSE ASSISTANT INSPECTOR GENERAL FOR AUDITING

Subj: DODIG DRAFT REPORT ON CONTROLS OVER MATERIEL PROCURED FOR DIRECT VENDOR DELIVERY (PROJECT NO. 3LE-0032)

Ref: (a) DODIG memo of 1 Nov 94

Encl: (1) Department of the Navy Comments

1. We have reviewed the finding and recommendations provided by reference (a). We concur with the finding and recommendations and will take action to emphasize existing requirements to maintain records, report discrepancies, and promptly acknowledge receipt of direct vendor delivery material.

2. Detailed comments are in enclosure (1).

DAVID R. OLIVER
By Direction

Copy to:
NAVCOMPT (NCB-53)
NAVINSGEN

DEPARTMENT OF THE NAVY RESPONSE
TO
DODIG DRAFT REPORT
ON
CONTROLS OVER MATERIEL PROCURED FOR DIRECT VENDOR DELIVERY
(PROJECT NO. 3LE-0032)

Finding. Detection of Undelivered Materiel

The Military Departments and Defense Logistics Agency did not have effective controls to detect and report undelivered materiel sent directly from vendors to DOD customers. The condition occurred because:

- DOD customers did not establish and maintain adequate records for materiel they were to receive;

- customers closed due-in records without either receiving the materiel or confirming with the wholesale supply organization that the materiel would not be sent;

- customers did not report receipt discrepancies, as required by DOD guidance; and

- customers did not acknowledge receipt of materiel to the wholesale supply organization.

As a result, we estimated that of 416,668 transactions, valued at $1.4 billion, for materiel provided to DOD customers, 39,191 transactions had unconfirmed or indeterminable receipt, which increased the risk that undelivered or incomplete shipments could go undetected.

DON Comment

Concur.

Recommendations

We recommend that the Army Deputy Chief of Staff for Logistics, the Commander, Naval Supply Systems Command, the Air Force Deputy Chief of Staff for Logistics, and the Director, Defense Logistics Agency, establish internal controls to ensure that DOD customers:

1. Establish and maintain adequate due-in and receipt records for direct vendor deliveries (DVD).

DON Comment

Concur. NAVSUP will draft and release a message to all major claimants and fleet activities emphasizing the existing requirements to establish, maintain, and reconcile due-in and receipt records for DVDs. Activities will be directed to include

due-in and receipt processing as an area for internal management control assessment. The estimated completion date is 28 February 1995.

2. Report all receipt discrepancies for DVDs.

DON Comment

Concur. Policy and procedures already are in place, as noted by the report, defining this requirement. NAVSUP will draft and release a message to all major claimants and fleet activities emphasizing the requirement to track and report via Report of Discrepancy (ROD) procedures all non-receipt of due-in DVD material. The estimated completion date is 28 February 1995.

3. Promptly acknowledge receipt of DVDs using the established Military Standard Transaction Reporting and Accounting Procedures (MILSTRAP).

DON Comment

Concur. NAVSUP will draft and release a message to all major claimants and fleet activities citing detailed descriptions and instructions relative to DVD material receipt transaction reporting. Estimated completion date is 28 February 1995.

Department of the Air Force Comments

DEPARTMENT OF THE AIR FORCE
HEADQUARTERS UNITED STATES AIR FORCE
WASHINGTON, D.C.

14 DEC 1994

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

FROM: HQ USAF/LGS
1030 Air Force Pentagon
Washington DC 20330-1030

SUBJECT: DoDIG Draft Audit Report, "Controls Over Material Procured for Direct Vendor Delivery" (Project No. 3LE-0032)

This is in reply to your memorandum requesting the Assistant Secretary of the Air Force (Financial Management and Comptroller) to provide Air Force comments on subject report.

Recommendation 1-3. Establish and maintain adequate due-in and receipt records for direct vendor deliveries. Report all receipt discrepancies for direct vendor delivery materiel. Promptly acknowledge receipt of direct vendor deliveries using the established Military Standard Transaction Reporting and Accounting Procedures.

The AF concurs with all findings and recommendations. The Air Force will take action to emphasize the importance of maintaining adequate records, and the prompt reporting of receipt, or lack thereof, on all DVD material. EDD: 30 Jan 95.

Air Force point of contact is Ms. DeGrange, DSN 225-4895.

KENNETH O. MILLER, BRIG GEN, USAF
Director of Supply
DCS/Logistics

cc:
SAF/FMPF

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY REFER TO DDAI

3 JAN 1995

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: DoD IG Draft Report on Controls Over Materiel Procured for Direct Vendor Delivery, 1 Nov 94, (Project No. 3LE-0032)

This is in response to your 1 November 1994 request.

2 Encl

FOR JACQUELINE G. BRYANT
Chief, Internal Review

cc:
AQPLC

TYPE OF REPORT: Audit

3 JAN 1995

PURPOSE OF INPUT: Initial Position

AUDIT TITLE & NO: Controls Over Materiel Procured for Direct Vendor Delivery (Project No. 3LE-0032)

FINDING: The Military Departments and Defense Logistics Agency did not have effective controls to detect and report undelivered materiel sent directly from vendors to DoD customers. The condition occurred because:

DoD customers did not establish and maintain adequate records for materiel they were to receive;

customers closed due-in records without either receiving the materiel or confirming with the wholesale supply organization that the materiel would not be sent;

customers did not report receipt discrepancies, as required by DoD guidance; and

customers did not acknowledge receipt of materiel to the wholesale supply organization.

As a result, we estimated that of 416,668 transactions, valued at $1.4 billion, for materiel provided to DoD customers, 39,191 transactions had unconfirmed or indeterminable receipt, which increased the risk that undelivered or incomplete shipments could go undetected.

DLA COMMENTS: Partially concur. Material receipt acknowledgement is a vital part of the materiel management process, not only for ensuring that our customers receive what they requisition, but also for measuring and improving customer support and logistics response time. Obtaining material receipt acknowledgement from the Services for DLA managed items has been, and continues to be, a problem for both DLA and DFAS. The Services do not consistently provide the required information, and in some cases are not required by regulation to provide this information (The IG identified the DoD and Joint Regulations, as well as the MILS requirements, governing the standard procedures for reporting materiel receipt acknowledgement and shipping/transportation discrepancies to the wholesale supply

organizations on pages 8 and 9 of the draft report. Certain Navy ships are exempt.) DLA has reiterated those procedures to all of its customers in our Customer Assistance Handbook. The Handbook provides office symbols and telephone extensions for requisition status, discrepancy reporting, and definitions of MILS codes for transactions processed through DAAS. Additionally, since we have been unsuccessful in obtaining the required information from the Services, we have established additional internal controls when DVD orders contain fast payment procedures designed to preclude fast pay abuse. DLA will perform 100 percent verification of customer receipt of material for all delivery orders issued above the small purchase threshold, and a statistically random sample verification for all delivery orders issued within the small purchase threshold. Additionally, VADM Straw, Director, DLA, has initiated action to pen a letter to the Services, in coordination with Mr. Klugh at OSD, to stress the importance of the material receipt acknowledgement document from the point of internal controls as stressed by the IG and also based on our reliance on that data to measure and improve upon customer support and logistics response time.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur
( ) Concur; however weakness is not considered material
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance

ACTION OFFICER: Amy Sajda, AQPLC
PSE REVIEW/APPROVAL: Marilyn Barnett/AQP/46401/22 Dec 94
COORDINATION: MMSLR (Bob Vitko/46388/13 Dec 94
D. Stumpf, DDAI, 23 Dec 94
J Bryant, DDAI, 23 Dec 94

DLA APPROVAL:

03 JAN 1995

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

TYPE OF REPORT: Audit

3 JAN 1996

PURPOSE OF INPUT: Initial Position

AUDIT TITLE & NO: Controls Over Materiel Procured for Direct Vendor Delivery (Project No. 3LE-0032)

RECOMMENDATION: Recommend that the Director, Defense Logistics Agency establish internal controls to ensure that DoD customers:

1. Establish and maintain adequate due-in receipt records for direct vendor deliveries.

2. Report all receipt discrepancies for direct vendor delivery materiel.

3. Promptly acknowledge receipt of direct vendor deliveries using the established Military Standard Transaction Reporting and Accounting Procedures.

DLA COMMENTS: Nonconcur. The appropriate regulations, procedures, and automated capabilities currently exist to provide DLA customers the information necessary for them to report discrepancies and materiel receipt acknowledgement to DLA, as well as to receive shipment status from DLA. Currently, customers are required to code their requisitions with the type of status they wish to receive, e.g., 100% supply status, exception status only, shipment status, all status. If shipment status is requested, it is automatically transmitted to the customer when the shipment posts to the ICP records through the MILS process. If shipment status is not requested by the customer, it is nonetheless transmitted automatically to DAAS per current MILSTRIP rules. Increased use of EDI for shipment information between contractors and the ICPs will generate faster shipment status to our customers when requested. It is incumbent upon each of the Services ordering supplies from DLA to accurately code their requisitions, to maintain adequate records of what they order, when they receive their material, discrepancies, and material receipt acknowledgement. DLA maintains the appropriate records necessary for the wholesale supply organization assigned inventory management responsibility for the items we manage. The customers are required to report this information to DLA. It should be noted that Approved MILS Change Letters (AMCLs)11 and 15, which have been postponed due to DoD's moratorium on MILS changes, would have required 100%

shipment status to customers regardless of how their requisitions were coded, required materiel receipt acknowledgement from everyone, and established a follow-up procedure if receipt acknowledgement is not received. The DoDIG should effect an exception to the moratorium on MILS changes to facilitate implementation of AMCLs 11 and 15.

DISPOSITION:
( ) Action is Ongoing. Estimated completion Date:
(X) Action is Considered Complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur
( ) Concur; however weakness is not considered material
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance

MONETARY BENEFITS:
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED

ACTION OFFICER: Amy Sajda, AQPLC
PSE REVIEW/APPROVAL: Margaret Janes/AQPL/46403/14 Dec 94
COORDINATION: MMSLR Bob Vitko/46388
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