# Audit Report

OFFICE OF THE INSPECTOR GENERAL

**LOCAL PROCUREMENT OF CENTRALLY MANAGED ITEMS**

Report No. 96-090 March 29, 1996

**Department of Defense**

**Additional Copies**

To obtain additional copies of this audit report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932.

**Suggestions for Future Audits**

To suggest ideas for or to request future audits, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (702) 604-8939 (DSN 664-8939) or FAX 604-8932. Ideas and requests can also be mailed to:

Inspector General, Department of Defense
OAIG-AUD (ATTN: APTS Audit Suggestions)
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

**Defense Hotline**

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9089; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing the Defense Hotline, The Pentagon, Washington D.C. 20301-1900. The identity of each writer and caller is fully protected.

**Acronyms**

| | |
|---|---|
| DFARS | Defense Federal Acquisition Regulation Supplement |
| ICP | Inventory Control Point |

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

March 29, 1996

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

SUBJECT: Audit Report on the Local Procurement of Centrally Managed Items (Report No. 96-090)

We are providing this audit report for review and comment. We conducted the audit in response to a request from the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management). Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The Deputy Under Secretary of Defense (Logistics) indicated that the audit results were already being put to use and concurred with the intent of all recommendations in the draft report. We request that he provide additional comments to clarify certain planned actions and the estimated completion dates for them.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Gordon Nielsen, Audit Program Director, at (703) 604-9402 (DSN 664-9402) or Mr. Terry Wing, Audit Project Manager, at (215) 737-3881 (DSN 444-3881). See Appendix I for the report distribution. The audit team members are listed on the inside back cover.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

# Office of the Inspector General, DoD

**Report No. 96-090** **March 29, 1996**
(Project No. 5LD-5007)

## Local Procurement of Centrally Managed Items

## Executive Summary


**Introduction.** This audit was requested by the Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management). DoD organizations acquire supplies under guidance provided by the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement. The Federal Acquisition Regulation states that organizations requiring supplies should generally requisition the supplies from the assigned inventory manager. However, under certain conditions, the Defense Federal Acquisition Regulation Supplement authorizes organizations to bypass the inventory manager and locally procure required supplies. Approximately 4.8 million items in the DoD wholesale supply system are centrally managed by DoD inventory managers. There is no centralized reporting of the number or value of local procurements of items centrally managed by DoD inventory managers.

Through various initiatives, DoD is attempting to inject business-like practices, market efficiencies, and a customer-oriented philosophy into the DoD business processes. Towards that end, the Principal Assistant Deputy Under Secretary of Defense (Logistics) submitted and obtained approval on November 9, 1995, for a change to the Defense Federal Acquisition Regulation Supplement to increase local purchase authority for centrally managed items. DoD anticipates that the approved change will contribute to its initiatives to reduce inventories and the logistics infrastructure by focusing the role of the central supply system on managing items where value is added (both cost economies and operational efficiencies).

**Audit Objectives.** The audit objectives were to determine the extent of local procurements of centrally managed items, evaluate compliance with existing guidance concerning local procurements of centrally managed items and the need for additional guidance, and determine the effectiveness of applicable controls.

**Audit Results.** DoD needs to address a variety of issues to successfully implement its initiatives to increase the use of local purchase authority and to focus the role of the central supply system on managing items where value is added. If not addressed, economies related to reduced inventories and logistics infrastructure costs, and increased operational readiness might not be realized and DoD would not be in a position to determine whether the goals of its initiatives were being achieved.

We were unable to determine the extent of local procurement of centrally managed items. However, procurement data provided by 13 organizations visited during the audit showed that only $7.2 million of $744 million (less that 1 percent) of the local procurements were for centrally managed items. The time frames of the procurement data provided by each organization varied, but the data were generally for FY 1994 and the first quarter of FY 1995.

**Potential Benefits of Audit.** Implementation of the recommendations will result in reduced logistics and procurement costs and increased operational readiness. However, we could not quantify the potential monetary benefits. The benefits associated with the audit are summarized in Appendix G.

**Summary of Recommendations.** We recommend that the Deputy Under Secretary of Defense (Logistics) develop procedures to have requisitioning organizations make greater use of local purchase authority for centrally managed items when local procurement is in the best interests of the Government; direct that requisitioning organizations develop procedures to determine the total cost of a local procurement; develop a detailed strategy to address the impact of the local purchase initiatives on centralized materiel management; and develop procedures addressing local procurement when inventory control points have excess stocks, reporting and recording of demand data for local procurements, and feedback on the progress and economies of local purchase initiatives.

**Management Comments.** The Deputy Under Secretary of Defense (Logistics) indicated that the audit results were already being put to use, concurred with the intent of all recommendations, and proposed alternate methods to meet the goals of the recommendations. The Deputy Under Secretary (Logistics) has requested that the Military Departments remove restrictions on local purchase authority beyond those in the Defense Federal Acquisition Regulation Supplement. The Deputy Under Secretary of Defense (Acquisition Reform) is taking the lead to develop a DoD-wide approach to further increase the use of the Government credit card. In addition, the Defense Logistics Agency is looking into expanding its marketing efforts to include price reductions, where appropriate, to maximize the use of excess stocks and is working with its customers to address the entire issue of demand data for local procurements. See Part I for a summary of management comments, and Part III for a complete text of management comments.

**Audit Response.** We consider the comments from the Deputy Under Secretary to be responsive to the recommendations. However, we request that he provide additional comments to clarify planned actions and to indicate estimated completion dates for certain actions by May 29, 1996.

# Table of Contents


**Executive Summary** i

**Part I - Audit Results**

Audit Background 2
Audit Objectives 3
Local Procurement of Centrally Managed Items 4

**Part II - Additional Information**

Appendix A. Audit Process 14
Scope 14
Methodology 14
Management Control Program 15
Appendix B. Summary of Other Reviews 17
Appendix C. Defense Federal Acquisition Regulation Supplement Guidance 19
Appendix D. Potential Benefits of Local Procurement of Centrally Managed Items 21
Appendix E. Procurement Data for Organizations Audited 22
Appendix F. Proactive Local Procurement Programs 23
Appendix G. Summary of Potential Benefits Resulting From Audit 25
Appendix H. Organizations Visited or Contacted 26
Appendix I . Report Distribution 28

**Part lll - Management Comments**

Deputy Under Secretary of Defense (Logistics) Comments 32

# Part I - Audit Results

# Audit Background

The Assistant Deputy Under Secretary of Defense (Materiel and Distribution Management) requested the audit. The Military Departments and the Defense Logistics Agency inventory control points (ICPs) provide spare parts support to military customers. The ICPs centrally manage over 4.8 million secondary line items in the DoD wholesale supply system. Secondary line items include consumables (such as computer supplies, nuts, and resistors) and repairables (such as engines and transmissions) used to maintain and support major end items of equipment. ICPs generally procure items in large quantities to achieve economies associated with volume buys, store the items in inventory, and ship the items to satisfy requisitioners requirements. ICPs bill requisitioners a standard price (cost of item plus a surcharge to cover expenses for managing items) for each item requisitioned.

**Adoption of Commercial Practices.** DoD has directed the Military Departments and the Defense Logistics Agency to use commercial practices to improve its logistics operations and reduce costs. The May 1990 inventory reduction plan noted, "...where DoD requirements can be met through commercial distribution systems in a timely and cost effective fashion, no value is added by pushing items through the DoD warehousing systems." In January 1993, DoD issued DoD Regulation 4140.1-R, "DoD Materiel Management Regulation" that required components to maximize the use of commercial distribution systems as an alternative to both wholesale and retail stockage.

The DoD Logistics Strategic Plan, July 17, 1995, provides specific objectives and strategies to meets it goals to reduce logistics cycle times and streamline the logistics infrastructure. Specifically, DoD was to:

o implement initiatives for decentralized ordering of commonly used commercial materials and items.

o expand methods, such as corporate contracting, which aggregate purchases from a single source across a broad range of items to reduce lead time, stockage, and contract administration.

o develop flexible logistics policies and procedures that allow support to be tailored based on the type of customer and nature of the product or service.

**Supply Sources for Secondary Items.** Defense Federal Acquisition Regulation Supplement (DFARS) part 208, "Required Sources of Supplies and Services," 1991 edition, states that organizations requiring materiel managed by an ICP must acquire the materiel from the ICP. However, the DFARS authorizes organizations, under certain conditions, such as when the purchase is in the best interest of the Government in terms of the combination of cost, quality, and timeliness, to bypass the central supply system and locally procure materiel from commercial suppliers.

On November 9, 1995, the Principal Assistant Deputy Under Secretary of Defense (Logistics) obtained approval from the Director, Defense Procurement, to revise the DFARS to enhance the authority of organizations to buy from the source offering the best value. The approved change to the DFARS incorporates the procurement thresholds created by the Federal Acquisition Streamlining Act of 1994. The approved change contributes to the DoD initiative to reduce the logistics infrastructure by helping to focus the role of the central supply system on managing items where value such as price discounts for volume purchases and quality assurances due to standardization and centralized contract administration, and increased operational readiness are added. Appendix C provides additional information on prior and recently adopted DFARS guidance.

**Defense Performance Review.** The Defense Performance Review established teams to inject business-like practices, a customer-oriented philosophy, and market efficiencies into DoD business processes. Two of the initiatives (Purchase Best Value Common Supplies and Services and Give DoD Installation Commanders More Authority and Responsibility Over Installation Management) identified actions to provide requisitioners the flexibility to access all sources of common supplies to obtain the best value for needed items. Those initiatives are discussed in Appendix B.

**Federal Acquisition Streamlining Act.** In October 1994, the Federal Acquisition Streamlining Act of 1994 was implemented. The Act established a simplified acquisition threshold of $100,000 (previously $25,000 was the small purchase threshold). The simplified acquisition threshold was designed to streamline the process of making small purchases and reduce the time required to process small purchases, resulting in substantial savings to the Government. The Act also established a micro-purchase threshold of $2,500 that allows organizations to maximize the use of Government credit card purchases to obtain required items from commercial sources. The Government credit card (International Merchants Purchase Authorization Card) program is managed by the General Services Administration. From October 1994 through May 1995, DoD organizations made over 900,000 credit card purchases valued at approximately $415 million.

## Audit Objectives

The audit objectives were to determine the extent of local procurements of centrally managed items, evaluate compliance with existing guidance concerning local procurements of centrally managed items and the need for additional guidance, and determine the effectiveness of applicable controls. See Appendix A for a discussion of the scope, methodology, and management control program and Appendix B for a summary of other reviews.

# Local Procurement of Centrally Managed Items

DoD needs to address a variety of issues to successfully implement its initiatives to increase the use of local purchase authority and focus the role of the central supply system on managing items where value (cost economies and operational efficiencies) is added. Procurement data provided by 13 organizations visited showed that only $7.2 million of $744 million (less that 1 percent) of their local procurements were for centrally managed items. DoD did not have implementation procedures to ensure that requisitioning organizations would make greater use of the increased local purchase authority when local procurement was in the best interest of the Government, and a detailed strategy in place to address the effects of the initiatives on ICP inventory management decisions, such as requirements computations, procurement quantities, and disposal decisions. If not addressed, economies related to reduced inventories and logistics and procurement infrastructure costs, and increased operational readiness might not be realized and DoD would not be in a position to determine whether the goals of the local purchase initiatives were being obtained.

## Centralized Management and Local Procurement

**DoD Logistics Policy.** DoD Directive 4140.1, "Materiel Management Policy," January 4, 1993, states that the Under Secretary of Defense for Acquisition shall monitor the overall effectiveness and efficiency of the DoD logistics system, and continually develop improvements. The Directive further states:

o DoD materiel management shall be structured to be responsive to customer needs during peacetime and war.

o All costs associated with materiel management shall be considered in materiel management decisions.

o The secondary item inventory shall be sized to minimize DoD investment while providing the inventory needed to support peacetime and war requirements.

o Materiel control and asset visibility of secondary item inventory shall be maintained.

**Anticipated Benefits of Local Procurement.** DoD anticipates significant benefits (cost savings and higher operational readiness) from increased use of the recently adopted DFARS local purchase authority and the use of the Government credit card for micro-purchases authorized by the Federal Acquisition Streamlining Act. The benefits summarized in Appendix D include those associated with the elimination of paperwork and administrative costs

associated with contracting actions, higher mission capable rates resulting from requisitioners receiving items faster than if ordered through the ICPs, reduced inventory levels, and reduced lead time to obtain supplies. A September 1994 Purchase Card Council (procurement executives from Government departments, such as Commerce; State; and Treasury, formed to promote broader use of the Government credit card) report stated that by using the credit card, organizations can save about $54 per transaction when compared with traditional Government purchasing and payment methods.

**Centralized Inventory Management.** The DoD logistics system is based on centralized inventory management. All items that are stocked, routinely distributed, or repetitively bought are included in the logistics system. Each item in the system is assigned a management code to indicate the ICP that manages the item and how organizations should obtain the item (acquisition advice code). The acquisition advice code, assigned by the ICP, tells the requisitioning organization whether to requisition the item through the ICP, to assemble or fabricate the item, or to obtain the item through local procurement. The ICP decision to manage an item on a decentralized (local procurement) or centralized basis and whether to support requisitioners demands from stock or from only direct vendor delivery (nonstocked) are made when items are assigned initially for materiel management. The decision on the method of management is periodically reviewed to determine whether the method should be changed.

**Procedures for Obtaining Items.** Unless organizations have a program to locally procure items and to bypass the central supply system, the following process is generally used to obtain required items. A user determines a need for an item and if the item is not on-hand, the item is ordered from the retail supply support activity. If the item is available at the retail supply support activity, the requirement is satisfied. If the item is not available at the retail supply support activity, each of the Military Departments have mechanized supply systems that contain Defense Logistics Services Center catalog data that show how items will be acquired (such as from local purchase or from an ICP) and the source of supply for the items. If the source of supply is an ICP, the retail supply system generates a requisition to the ICP. The ICP fills the requisition if stock is available. If the stock is not available, the ICP backorders the requisition and provides the requisitioner an estimated delivery date. If the requisitioner determines that the estimated delivery date is unacceptable, the requisitioner will generally procure the item locally and cancel the requisition sent to the ICP. If the required item is not centrally managed or if the catalog data show that the ICP has authorized local procurement, the requisitioner will generally purchase the item locally.

**Extent of Local Procurements of Centrally Managed Items.** The number of or value of local procurements of items centrally managed by the ICPs is not centrally reported. However, organizations submit over 25 million requisitions to ICPs annually, and in FY 1994, according to the Defense Logistics Agency and Military Department financial statements, the ICPs reported sales of $33.6 billion to Government organizations.

# Local Procurement Issues

DoD needs to address a variety of issues to successfully implement its initiatives to increase the use of local purchase authority and to focus the role of the central supply system on managing items where value is added. Specifically, the issues are:

- o organization requisitioning procedures,
- o cost of local procurement,
- o centralized management concept,
- o ICP asset position,
- o reporting and recording of demand data, and
- o effectiveness of local purchase initiatives.

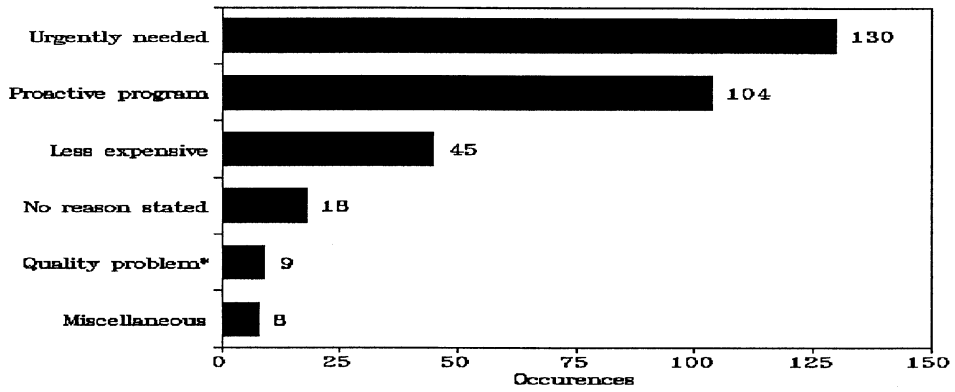
**DoD Local Procurement Policy.** DoD did not have implementation procedures or a detailed strategy to ensure that the benefits anticipated from its initiatives to increase local procurements of centrally managed items were achieved. Those initiatives represent a fundamental change in the process Military Department organizations use to obtain items and in the DoD concept of centralized inventory management. The success of the initiatives hinged on the ability of DoD to provide requisitioning organizations and ICPs the specific guidance needed to make effective and efficient decisions.

**Organization Requisitioning Procedures.** Requisitioning organizations need to have proactive programs to implement DoD initiatives to increase local purchases of centrally managed items. With few exceptions, personnel at the 13 requisitioning organizations visited told us that centrally managed stocks were the organizations preferred choice of supply.

Procurement data provided by the 13 requisitioning organizations showed that only $7.2 million of $744 million (less than 1 percent) of their local procurements were for centrally managed items. The time frames of the procurement data provided by each organization varied, but the data were generally for FY 1994 and the first quarter of FY 1995. The 13 organizations (public works, research and development, shipyard, and tactical) had missions that required using various types of centrally managed items. The types of centrally managed items that were procured locally included such items as tires ($331,000), electrical lamps and hardware ($286,000), wire and cable ($285,000), and piping and tubing ($138,000). Appendix E provides information on the procurement data provided by each organization.

We judgmentally selected a sample of 314 local procurements (contracting actions and credit card buys) of 262 items that were centrally managed to determine the basis for the procurements. The procurements were valued at

approximately $527,000. The annual demand at ICPs for those items for all requisitioning organizations was approximately $32 million. During FY 1995 the 13 organizations, in addition to the local procurements of $527,000, also requisitioned approximately $850,000 of the items from the ICPs. Thus, the potential existed for additional local procurements. The following figure shows the reasons for the 314 local procurements.




*Items previously received from the supply system did not meet specifications or were received in a not ready for issue condition.

**Reasons Cited for Local Purchase of Centrally Managed Items**

Of the organizations visited, three had documented proactive programs to bypass the central supply system and to procure locally specific types of centrally managed items. The reasons provided for establishing the programs were that items could be obtained cheaper locally and organizations were not satisfied with the responsiveness of the central supply system. Two organizations were public works facilities with a mission to maintain and repair buildings, roads, etc. The mission of the other organization was research and development. Appendix F describes the proactive programs.

Of the 13 organizations visited, 10 had not established proactive programs. The primary reason given was that the organizations' retail supply systems were programmed to requisition centrally managed items from the ICPs. The organizations did not have the resources (procurement and supply) to proactively bypass the established requisitioning process to determine whether local procurement of centrally managed items was in the best interest of the organization. Additionally, users of material that initiated the requirements for items were generally not concerned with the costs or potential savings associated with local procurement of centrally managed items. The users needed the items to accomplish their mission and were evaluated on mission accomplishment. If the ICPs could meet their needs, central supply system stocks were used. If the ICP couldn't deliver items timely, then local procurement was used.

**Cost of Local Procurement.** We support the DoD initiatives to increase local procurement authority, but DoD requisitioning organizations must develop procedures to ensure that when used, local procurements are in the best interests of the Government. Both the current and newly adopted DFARS local procurement guidance state that local procurement is authorized when the procurement is in the best interest of the Government in terms of the combination of cost, quality, and timeliness. Regarding costs, DoD is generally not aware of the total cost (administrative processes, materiel, transportation, etc.) of locally procuring centrally managed items. Without cost data, neither DoD nor its requisitioning organizations are in a position to determine whether local procurement is in the best interest of the Government.

In comparing the price the 13 organizations paid (materiel and sometimes transportation) with the standard price charged by the ICPs for our sample items, the local prices were lower by $176,636 in 136 procurements, higher by $80,761 in 176 procurements and the same for 2 procurements. The price differences may be misleading because the actual cost of local procurements was not readily determined. Further, the most economic and effective method for obtaining items could vary from organization to organization. Every organization is unique in terms of mission it must support and the types of items available and the competitiveness of the local economy.

**Concept of Centralized Management.** DoD needs to address the effects of increased local procurement on ICP management decisions. One of the roles of the ICPs is to procure and maintain inventories of items so that the items can be provided to requisitioners, in both peacetime and hostilities, anywhere in the world in a reasonable time frame and at a stable price. Under the local purchase initiatives, requisitioning organizations, will have greater authority to locally procure centrally managed items. If DoD does not redefine the role of the ICPs, both the ICPs and requisitioning organizations could maintain duplicate purchasing and logistics infrastructures for the same items and possibly maintain duplicate inventory levels (for example, safety levels). Additionally, because local organizations and ICPs would be buying the same items, DoD could face a situation where it is competing with itself for items. That competition would be critical in surge times for emergencies and war in which limited producers for items were available. Under the centralized supply system, organizations that have the most critical missions receive priority for obtaining items. The priority sequencing would not be assured if DoD organizations were competing against each other.

Because an item is centrally managed does not in and of itself preclude that item from also being locally purchased. The two purchasing approaches cannot in all situations be mutually exclusive. DoD requisitioning organizations, under certain circumstances, always have been permitted to procure locally centrally managed items. It is only the degree of local purchasing of centrally managed items that is at issue. One option is for DoD to identify specific types of items (such as items bought to commercial specifications that are used in base maintenance, civil engineering, and related functions) to be locally procured, but also, if necessary, have the ICPs provide limited support to organizations that do not have neither the resources nor capability (overseas organizations) to obtain needed items locally.

The selection of the types of centrally managed items to be locally procured should not conflict with other DoD inventory reduction initiatives, such as the medical prime vendor program, Paperless Order Placement System, and corporate or long-term contracting. With those initiatives, DoD has centralized contracting programs with indefinite delivery contracts for direct delivery to requisitioners. The benefits of those initiatives included local procurement along with the potential for lower prices because of volume buys.

**ICP Asset Position.** DoD did not have policy and procedures relating to requisitioners depleting excess stocks at the ICPs before locally procuring centrally managed items. Excess stocks should be requisitioned, unless requisitioning organizations have urgent requirements, to minimize the possibility of ICPs disposing of assets that were being locally procured.

**Reporting and Recording of Demand Data.** Requisitioning organizations were generally not reporting demand for local procurements and retail supply support organizations and ICPs were not always recording and using the local procurement demand data. One factor that retail supply support organizations and ICPs generally use to forecast their requirements, determine procurement quantities, and make disposal decisions is demands received by a customer. With requisitioning organizations having the option either to locally procure or to use the central supply system, the retail supply support organizations and ICPs will have no assurance that future demands would materialize. That will adversely affect the accuracy of inventory management decisions. Demand reporting is also an initiative in the DoD Total Asset Visibility Plan. As envisioned by the Plan, retail supply support organizations and ICP supply systems must have demand data to provide accurate and timely supply intelligence for planning and rapid requirements determination and procurement to meet emergency or wartime needs.

Each of the Military Departments had procedures for retail supply support organizations to accumulate demands for local procurements. However, no mechanism was in place for the organizations to accumulate demands related to credit card purchases.

DoD procedures provide for a demand only transaction (document identifier DHA) to be transmitted to ICPs. However, the procedures do not specify the purpose of the transaction or how the transaction recipient is to use the information. Our review of DHA transactions submitted through the Defense Automatic Addressing System showed that only the Army and the Navy organizations routinely submitted DHA transactions. However, the Army transactions related to redistribution of items within the Army and not local procurements. The Navy transactions were for local procurement contracting actions, not credit card purchases.

Navy procedures provide that requisitioning organizations will submit DHA transactions for all stock numbered items, not authorized for local purchase, obtained through locally initiated purchase, manufacture and repair actions. The procedures also provide that Navy ICPs have the capability to accept and record DHA transactions and that the recording of the demand is an important element in identifying future items requirements and in positioning items.

Neither the Military Departments nor the Defense Logistics Agency ICPs we visited had used the DHA transactions in inventory management decisions or had procedures to show what would be done with the transactions when the transactions were received.

**Effectiveness of Local Purchase Initiatives.** DoD had not established procedures to determine whether the benefits of the local purchase initiatives will be obtained. The Government Performance and Results Act of 1993 stated that Federal managers are seriously disadvantaged in their efforts to improve program efficiency and effectiveness because of insufficient articulation of program goals and inadequate information on program performance. One of the purposes of the Act was to require that managers plan for meeting program objectives and provide them with information about program results.

As mentioned previously, no centralized reporting of the number or value of local procurements of items centrally managed by DoD inventory managers was done. Without that data or other data to show cost savings or efficiencies associated with local procurement of centrally managed items, DoD will not be able to determine the success of its initiatives.

## Recommendations, Management Comments, and Audit Response

**We recommend that the Deputy Under Secretary of Defense (Logistics):**

**1. Develop a plan to have requisitioning organizations make greater use of increased local procurement authority when local procurement is in the best interest of the Government. At a minimum, the implementing procedures should direct that the Military Departments establish proactive local procurement programs for centrally managed items with commercial specifications, such as items used in base maintenance, civil engineering, and related functions when local purchases of such items are in the best interests of the Government.**

**Management Comments.** The Deputy Under Secretary concurred with the intent of the recommendation and proposed an alternate method to meet the goal of the recommendation. The Deputy Under Secretary has requested the Military Departments to remove restrictions on local purchase authority, beyond those in the DFARS coverage, from regulations issued by the Military Departments. Implementating those revisions will significantly increase the flexibility of local commanders to seek best value sources and meet the goal of the recommendation

**Audit Response.** Comments from the Deputy Under Secretary were responsive. However, we request that he indicate an estimated date by which the Military Departments will remove restrictions on local purchase authority, beyond those in the DFARS, from regulations issued by the Military Departments.

**2. Direct requisitioning organizations to develop procedures to determine the total cost (materiel, transportation, and personnel costs) of a local procurement so that the organizations can evaluate whether local procurement is more cost-effective than using the central supply system.**

**Management Comments.** The Deputy Under Secretary concurred with the intent of the recommendation and proposed an alternate method to meet the goal of the recommendation. The Deputy Under Secretary stated that many reviews of the cost of accomplishing particular purchase actions have been conducted over the years, with varying results. He also stated that the significant increase in the DoD use of the Government credit card overtakes the issue of determining the cost of effecting a local purchase. Use of the credit card reduces administrative costs traditionally associated with conducting a local purchase as opposed to using the central supply system. The total DoD usage of the card increased from $365 million in FY 1994 to $798 million in FY 1995. The Deputy Under Secretary of Defense (Acquisition Reform) is taking the lead to develop a DoD-wide approach to further increase use of the card.

**Audit Response.** Comments from the Deputy Under Secretary were partially responsive. However, we request that he provide more specific information on the efforts to develop a DoD-wide approach to further increase the use of the Government credit card and an estimated date of when those efforts will be completed.

**3. Develop a detailed strategy to address the impact of the local purchase initiatives on centralized materiel management. The strategy must consider the effects of increased local procurement on the logistics infrastructure and supply levels, competition for supplies, and inventory control point centralized procurement initiatives, such as the prime vendor program.**

**Management Comments.** The Deputy Under Secretary concurred with the intent of the recommendation and proposed an alternate method to meet the goal of the recommendations. The Deputy Under Secretary stated that aggressive and proactive measures by the centralized materiel management system are the most effective means of accomplishing the recommendation. He also stated that the Defense Logistics Agency (DLA) is working with DoD Components and the General Services Administration to initiate a program using the Government credit card as a method through which DoD organizations can obtain items directly from commercial distributors at discounted prices negotiated by DLA.

**Audit Response.** Comments from the Deputy Under Secretary were partially responsive. However, we request that he provide more specific information on the aggressive and proactive measures by the centralized materiel management system that would address the impact of increased local purchases and a target date of when those measures will be completed.

**4. Develop procedures requiring that requisitioning organizations requisition inventory control point stocks that are in an excess supply position, unless a delay in delivery would adversely affect mission requirements, before locally procuring the items.**

**Management Comments.** The Deputy Under Secretary concurred with the intent of the recommendation and proposed an alternate method to meet the goal of the recommendation. The Deputy Under Secretary stated that DLA is looking into expanding its marketing efforts to include broadcasting information about common-use, commercially available items of the type most likely to be purchased locally, when such items are in excess supply at DLA. He further stated that the use of aggressive marketing techniques, including price reductions, where appropriate, will also be used.

**Audit Response.** Comments from the Deputy Under Secretary were responsive. However, we request that he provide an updated status on the DLA marketing initiatives and an estimated target date of when the initiatives will be implemented.

**5. Develop procedures to address the requisitioning organizations' reporting of demand for local procurement (contracting actions and credit card purchases) of centrally managed items and the recording and use of the demand in requirements forecasts and disposal decisions at both retail supply support organizations and inventory control points.**

**Management Comments.** The Deputy Under Secretary concurred with the intent of the recommendation and proposed an alternate method to meet the goal of the recommendation. The Deputy Under Secretary stated that DLA is taking the lead in this area by working with its customers to improve the entire process.

**Audit Response.** Comments from the Deputy Under Secretary were partially responsive. However, we request that he provide more specific information on the DLA initiatives for reporting and recording of demand data to include the use of document identifier code DHA transactions and an estimated completion date for the actions.

**6. Establish procedures for the Military Departments and the Defense Logistics Agency to use in providing feedback on the progress and economies of local procurement initiatives and any problems encountered with implementing the initiatives.**

**Management Comments.** The Deputy Under Secretary concurred with the intent of the recommendation and proposed an alternate method to meet the goal of the recommendation. The Deputy Under Secretary stated that his office is in discussions with the Military Departments concerning their efforts to provide greater flexibility in allowing the use of local purchases when it is in the best interest of the Government. He proposes to continue the dialogue with the Military Departments and will offer all possible assistance.

**Audit Response.** Comments from the Deputy Under Secretary were responsive. The DoD acquisition reform, logistics and finance communities all need to be proactive in seeking continued feedback on the progress of the local procurement initiatives. Further audit support is also a future option.

# Part II - Additional Information

# Appendix A. Audit Process

## Scope

To accomplish the audit objectives, we reviewed local procurements made by 13 requisitioning organizations. The organizations (five Army, five Navy, and three Air Force) were judgmentally selected based on the type and mission of the organization, suggestions by DoD personnel, and the dollar value of local procurement data (contracting actions reported to the Federal Procurement Data System and International Merchants Purchase Authorization credit card purchases recorded in the Rocky Mountain Bank Card System). Those systems had data to show the total value of local procurements for each organization, but did not contain the data needed (national stock number) to identify the portion of the local procurements that were for centrally managed items.

To determine the extent of local procurements of centrally managed items, we requested that each organization provide us computer data base files of procurement data for FY 1994 and the first quarter of FY 1995. The data provided contained contracting actions (credit card purchase data were generally not mechanized) for services, local stock numbers, part numbers, and national stock numbers. The time frames of the contracting actions varied by organization because of the availability and retention of the data we requested. The value of the procurement data was $744 million.

## Methodology

For national stock number contracting actions, we used catalog data maintained by the Defense Logistics Services Center to identify local procurements of centrally managed items that the organization could have requisitioned from DoD ICPs. We concentrated our review on procurements of hardware items and excluded procurements of clothing and textiles, fuel, medical, and subsistence items. The value of local procurements of centrally managed items was $7.2 million. For credit card purchases, we used data recorded in the Rocky Mountain Bank Card System from December 1994 through February 1995 to identify and judgmentally select purchases that had the potential (from either the description of the item purchased or the type of organization purchasing the items) to be centrally managed items. We judgmentally selected for review a sample of 314 local procurements, valued at approximately $526,000, of centrally managed items based on dollar value of procurements, and the number of times a national stock number was locally procured. Of the 314 local procurements, 101 valued at approximately $37,400, were for

credit card purchases and 213, valued at approximately $489,100, were for contracting actions. For each contracting action and credit card purchase selected, we attempted to determine the reason for local procurement.

We interviewed personnel at requisitioning organizations, and at Military Department and Defense Logistics Agency headquarters to determine the procedures used to procure locally centrally managed items and to determine whether there were any proactive programs to locally procure centrally managed items and record, report, and use the demand data associated with the procurements. We also reviewed FYs 1994 and 1995 contracting and supply data at ICPs for the procurements selected for review.

## Use of Computer-Processed Data

Although we did not perform a formal reliability assessment of the computer-processed data, we determined that the local procurement contract and credit card purchase data reviewed generally agreed with the information in the computer-processed data. We did not find errors that would preclude using the computer-processed data to meet the objectives of the audit or that would change the conclusions in the report. In addition, we verified that the total value of the procurement data provided was in general agreement with other sources of procurement statistics.

## Audit Period, Standards, and Locations

This economy and efficiency audit was made from November 1994 through September 1995. 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, and accordingly, included such tests of management controls as were considered necessary. The organizations we visited or contacted are in Appendix G.

## Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, 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 over the process used to locally procure centrally managed items in lieu of requisitioning the items from the central supply system. We did not assess the adequacy of management's self-evaluation of those controls.

**Adequacy of Management Controls.** The management controls we reviewed were adequate in that we identified no material management control weaknesses. If management implements all the report recommendations, the process that organizations use to obtain supplies would be improved, central supply system stocks could be reduced, and potential monetary benefits could be realized. However, we could not determine the amount because the amount depends on the extent of local procurements of centrally managed items and any potential monetary benefits associated with the procurements and reduced costs for potential reductions in central supply systems stock. See Appendix G for a summary of all potential benefits resulting from the audit.

# Appendix B. Summary of Other Reviews

**Defense Performance Review.** Defense Performance Review initiatives embrace the principles to operate more effectively and at less cost, and to be oriented toward results and performance. Some of the initiatives that affect local procurement of centrally managed items follow.

**Purchase Best Value Common Supplies and Services.** To provide best value common supply items and service, DoD must streamline existing acquisition guidelines and adopt commercial business practices like competition, credit cards, and electronic commerce. Ultimately, DoD personnel should be able to access all sources of supplies and services to obtain best value products.

**Give DoD Installation Commanders More Authority and Responsibility Over Installation Management.** Installation managers need more flexibility to negotiate, obligate, price, and determine the source of supply for best value supply items and services directly from a provider. Restrictive directives and regulations drive up costs by inhibiting the commander from shopping smart. In addition, DoD should provide savings incentives to installation commanders that would authorize installation commanders to retain savings (or cost avoidance) that result from process improvements and productivity enhancements.

**Air Force Reviews.** The Air Force Logistics Management Agency conducted two tests to increase Air Force base wing commanders ability to meet critical mission needs, encourage efficiency, and reduce costs. The test programs provided wing commanders the flexibility to purchase certain supply items through local procurement in lieu of requisitioning supplies from the central supply system. The objectives of the test programs were to determine whether local purchases provided cheaper and more responsive means of procuring items versus requisitioning the items from the central supply system, and whether more specific guidelines could be provided to wing commanders to assist in their decisions as to when a local purchase is more appropriate than requisitioning items from the supply system.

**Air Force Report No. LC922113, "Wing Commander Flexibility Test Program," September 1993.** The subject test report was limited to consumable items related to aerospace ground support, communications, electronics (non-weapons and nonspace systems) equipment, and vehicles. The test included data for 232 transactions from 10 Air Force bases from October 1991 through March 1993. The report concluded that based on either price or delivery, local procurement for 210 (90 percent) of the 232 transactions was more advantageous to the Government than requisitioning the items from the central supply system.

**Air Force Report No. LC9434300, "Local Procurement Test Program Phase II," January 1995.** The subject test report expanded the types of items that were evaluated in the Wing Commanders Flexibility Test Program to include aerospace aircraft, communications-electronics equipment, ground support equipment, missiles, space systems, and vehicles. Twenty-three sites were selected to participate in the test, but only 13 provided data on 261 transactions that were considered for local procurements. The test concluded that in 163 of the transactions, local procurement (cost of materiel and a 8.34 percent base supply surcharge) was $189,000 less expensive than using the central supply system. In 154 of the transactions, the delivery of the supply items was faster than the central supply system. For 86 transactions, the local procurement was $44,000 higher than the central supply system standard price; and in 12 transactions, there was no cost difference. The report recommended that DFARS be changed to expand the authority of installation commanders to procure locally centrally managed items when approved by installation commanders, and that a system be developed to provide local procurement data for centrally managed items to the inventory manager to provide visibility of war readiness requirements and item usage.

# Appendix C. DFARS Guidance

On November 9, 1995, the Principal Deputy Under Secretary of Defense (Logistics) obtained approval from the Director, Defense Procurement, on a change to DFARS guidance relating to required sources of supplies and services. The following is the approved change in guidance (deletions with strikethroughs and additions in bold type).

208.7003-1 Assignments under integrated materiel management (IMM).

(a) All items assigned for IMM must be acquired from the IMM except

(1) Items purchased under circumstances of unusual and compelling urgency as defined in Federal Acquisition Regulation (FAR) 6.302-2. After such a purchase is made, the requiring ~~department~~ **activity** must send one copy of the contract and a statement of the emergency to the IMM manager.

(2) Items the IMM manager assigns a supply system code for local purchase, or otherwise grants authority to purchase locally.

(3) When the purchase by the requiring ~~department~~ **activity** is in the best interest of the Government in terms of the combination of cost, quality, and timeliness that best meets the requirement. This exception does not apply to items

~~(i) Necessary for war reserve or war mission requirements, required for unit deployment, or to support the industrial base;~~

~~(ii)~~ **(i)** ~~Directly related~~ **Critical** to the **safe** operation of a weapon system ~~or its support equipment~~;

~~(iii)~~ **(ii)** With special security characteristics; or

~~(iv)~~ **(iii)** Which are dangerous (for example, explosives, munitions).

(b) When an item assigned for IMM is acquired by the requiring ~~department~~ **activity** under paragraph (a)(3) of this subsection, the contracting officer must (1) document the contract file with a statement of the specific advantage of local purchase for an acquisition ~~over $100 per line~~ item **exceeding the micro-purchase threshold in FAR part 13;** and (2) ~~obtain~~ **ensure that** a waiver **is obtained** from the IMM manager **before initiating** ~~for~~

**an acquisition** ~~over $5,000 per line item~~ **exceeding the simplified acquisition threshold in FAR part 13,** if the IMM assignment is to the General Services Administration, the Defense Logistics Agency, or the Army Materiel Command.

# Appendix D. Potential Benefits of Local Procurement of Centrally Managed Items

| Anticipated or Potential Benefits | Supply System Levels | | |
|---|---|---|---|
| | Retail | Wholesale | Depot |
| Improved readiness | X | - | - |
| Minimize job delays | X | - | - |
| Reduced accounting paperwork | X | - | - |
| Reduced cost | X | X | X |
| Reduced inventory | X | X | X |
| Reduced obsolescence | X | X | - |
| Reduced pilferage | X | X | - |
| Reduced response time | X | - | - |
| Reduced warehouse space | X | - | X |

# Appendix E. Procurement Data for Organizations Audited

| Organization | Local Purchases | Centrally Managed[1] | Period |
|---|---|---|---|
| Aberdeen Proving Ground[2] | $109,425,560 | $ 257,135 | Oct. 93 - Feb. 95 |
| FISC Jacksonville[3] | 92,206,835 | 1,462,870 | Oct. 93 - Nov. 94 |
| Fort Campbell[2] | 6,558,851 | 252,895 | Oct. 94 - Jan. 95 |
| Fort Hood | 32,311,443 | 115,940 | Oct. 93 - Feb. 95 |
| McGuire Air Force Base | 76,442,957 | 14,949 | Oct. 93 - Dec. 94 |
| NAWCWPNS China Lake[2,4] | 81,920,305 | 375,359 | Oct. 93 - Feb. 95 |
| Norfolk Public Works | 48,717,227 | 1,025,618 | Oct. 93 - Oct. 94 |
| Offutt Air Force Base | 57,061,363 | 39,953 | Oct. 93 - Mar. 95 |
| PWC San Diego[5] | 46,613,819 | 1,437,910 | Oct. 93 - Mar. 95 |
| Puget Sound Naval Shipyard | 66,949,603 | 2,023,964 | Oct. 93 - Dec. 94 |
| Travis Air Force Base | 114,425,998 | 144,646 | Oct. 93 - Mar. 95 |
| 3rd ID[6] | 76,537 | 10,690 | Oct. 93 - Dec. 94 |
| 200th TAMMC[7] | 11,302,982 | 49,925 | Nov.93 - Dec. 94 |
| **Total** | **$744,013,480** | **$7,211,854** | |

[1]Local purchase of centrally managed items.
[2]Includes credit card transactions.
[3]Fleet Industrial Supply Center.
[4]Naval Air Warfare Center Weapons Division.
[5]Public Works Center.
[6]Infantry Division.
[7]Theater Army Materiel Management Center.

# Appendix F. Proactive Local Procurement Programs

Of the 13 organizations we visited, 3 had documented proactive programs to bypass the central supply system and to procure locally centrally managed items.

**Naval Air Warfare Center Weapons Division, China Lake.** In an effort to improve procurement support to its technical personnel, management at the Naval Air Warfare Center Weapons Division, China Lake developed the Small Purchase Electronic Data Interchange program (the program) and aggressively used the Government credit card. The program is based on requirements-type contracts using just-in-time warehousing and delivery concepts. Orders are placed via personal computer and feature on-line catalogs and search capability. The program was designed to greatly improve the response time from initiation of the requirement through receipt of the materiel, to reduce inventory levels and costs and to reduce the total procurement effort by consolidating recurring requirements. Program contracts exist for automated data processing peripherals, electrical items, office items and paint, paint related items, and plumbing supplies.

The Warfare Center had conducted a study to identify the total average life cycle processing costs for a procurement line (based on FY 1993) and found that the bank card was $26.39, the program was $97.18 and the supply system was $270.38 (we did not validate the cost data). For program purchases, lead time has been reduced from 95 days to 3 days. In FY 1994, purchases under program contracts totaled over $2.7 million. From September 1994 through May 1995, over 18,000 credit card transactions were processed for $11.9 million dollars.

**Public Works Center, San Diego Naval Shipyard.** The San Diego Naval Shipyard is responsible for the maintenance of buildings and grounds on the shipyard and various off site locations. The majority of its work consists of emergency and service repairs taking less than 7 and 14 days, respectively, from start to finish. The proactive local procurement program was initiated because of job execution delays. The central supply system was not responsive to the needs of the Public Works Center.

In April 1987 the Public Works Center requested a waiver from the Secretary of the Navy for relief from technical screening for nonstandard items and the use of the Federal Supply System for standard stock items not in stock or not carried at the Naval Supply Center, San Diego. In January 1988 the Navy granted the Public Works Center a waiver for 1 year. During that test period the Public Works Center was given permission to buy 96 different Federal supply classes, locally. All the supply classes were for hardware or construction type items. The waiver contained some restrictions. For example, buying locally applied only to emergency, nonrecurring requirements for material that was not maintained in the Public Works Center shop stores, recurring type work, planned road maintenance, and overhead requirements.

As a result of the test, the Public Works Center concluded that local procurement was in its best interests regarding completion of required maintenance, cost of materiel, reduction of inventory levels and warehouse space, and timeliness of delivery. On September 11, 1990, the Navy granted the waiver for all Public Work Centers to locally purchase centrally managed items. The same restrictions applied that were applicable during the test period.

**60th Base Civil Engineering Squadron, Travis Air Force Base.** The 60th Base Civil Engineering Squadron, is responsible for maintaining the entire infrastructure at Travis Air Force Base, to include all base housing. The Engineering Squadron entered into a memorandum of understanding with the 60th Air Mobility Wing, Chief of Supply, which dictates that the Engineering Squadron will obtain virtually all supply items by using the Government credit card in lieu of using base supply or base contracting.

The program was initiated because of problems the Engineering Squadron was experiencing in timely obtaining the correct items it required using either base supply or base contracting. The memorandum was initiated on January 25, 1994, and encompassed all Civil Engineering Materiel Acquisition System stock list items. Most of the items were to keep the physical plant at the base operational. Items required were for the maintenance of approximately 500 buildings and their air conditioning, heating, and ventilating systems as well as for maintenance of all roadways and runways associated with the base mission. According to the memorandum, before the Engineering Squadron is authorized to obtain items on its own, it must first ensure that no residual stocks are on hand at base supply.

# Appendix G. Summary of Potential Benefits Resulting From Audit

| Recommendation Reference | Description of Benefit | Amount and Type of Benefit |
|---|---|---|
| 1., 2., 3., 4., 5., and 6. | Economy and Efficiency. Improved readiness and minimize job delays. Also, reduced accounting and finance paperwork, costs, inventory levels, obsolescence, pilferage, and warehouse space. | Undeterminable, because the benefits will not occur unless requisitioning organizations make use of the increased local purchase authority to locally purchase centrally managed items when the purchases are in the best interest of the Government. |

# Appendix H. Organizations Visited or Contacted

## Office of the Secretary of Defense

Office of the Under Secretary of Defense (Logistics) Washington, DC

## Department of the Army

Deputy Chief of Staff (Logistics), Supply and Maintenance Policy, Washington, DC
Army Materiel Command, Alexandria, VA
  U.S. Army Communications and Electronics Command, Fort Monmouth, NJ
  U.S. Army Tank-automotive Command, Warren, MI
Tobyhanna Army Depot, Tobyhanna, PA
Fort Campbell, Fort Campbell, KY
Fort Hood, Kileen, TX
Aberdeen Proving Ground Support Activity, Aberdeen, MD
U.S. Army Corps of Engineers, Europe District, Frankfurt, GE
Headquarters, U.S. Army Europe, Heidelberg, GE
26th Area Support Group, Heidelberg, GE
98th Area Support Group, Wurzburg, GE
200th Theater Army Materiel Management Command, Kaiserslautern, GE
21st Theater Army Area Command, Kaiserslautern, GE
U.S. Army Europe Contracting Center, Frankfurt, GE
3rd Infantry Division, Wurzburg, GE

## Department of the Navy

Naval Supply Systems Command, Washington, DC
  Navy Aviation Supply Office, Philadelphia, PA
Naval Air Station, Jacksonville, FL
Naval Air Warfare Center, China Lake, CA
Naval Aviation Depot, Jacksonville, FL
Fleet Industrial Supply Center, Jacksonville, FL
Fleet Industrial Supply Center, Norfolk, VA
Fleet Industrial Supply Center, Puget Sound, WA
Naval Ships Parts Control Center, Mechanicsburg, PA
Navy Publics Work Center, Norfolk, VA
Navy Publics Work Center, San Diego, CA
Puget Sound Naval Shipyard, Puget Sound, WA

## Department of the Air Force

Deputy Chief of Staff (Logistics and Engineering), Supply Policy, Washington, DC
Air Force Materiel Command, Dayton, OH
Offutt Air Force Base (AFB), Omaha, NE
Travis AFB, Vacaville, CA
McGuire AFB, Wrightstown, NJ
San Antonio Air Logistics Center, Kelly AFB, TX
Sacramento Air Logistics Center, McClellan AFB, CA
Warner Robins Air Logistics Center, Robins AFB, GA
Eglin AFB, Ft. Walton Beach, VA

## Other Defense Organizations

Defense Logistics Agency, Cameron Station, VA
- Defense Construction Supply Center, Columbus, OH
- Defense Electronics Supply Center, Dayton, OH
- Defense General Supply Center, Richmond, VA
- Defense Industrial Supply Center, Philadelphia, PA

## Non-Defense Federal Organizations

General Services Administration, Washington, DC
Rocky Mountain Bank Card Company, Denver, CO

# Appendix I. Report Distribution

## Office of the Secretary of Defense

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

## Department of the Army

Assistant Secretary of the Army (Installations, Logistics, and Engineering)
Commander, Army Materiel Command
Auditor General, Department of the Army

## Department the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy
Commander, Naval Supply Systems Command

## Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Headquarters, Deputy Chief of Staff Logistics
Auditor General, Department of the Air Force

## 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

## Non-Defense Federal Organizations and Individuals

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

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 III - Management Comments

# Under Secretary of Defense (Logistics) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

ACQUISITION AND TECHNOLOGY

21 FEB 1996

(L/MDM)

MEMORANDUM FOR DOD INSPECTOR GENERAL
THROUGH: CHIEF, CAIR 21 Feb 96

SUBJECT: Draft Audit Report on the Local Procurement of Centrally Managed Items (Project No. 5LD-5007)

This responds to your memorandum of December 13, 1995, on the subject draft audit report. There are six recommendations to this office, which are addressed in the attachment.

This office appreciates the work of the auditors in performing this review, which we requested. The draft audit report provides information that we are already putting to use in implementing a series of important initiatives, ranging from increasing use of the Government credit card within the Department of Defense (DoD), to new or intensified customer support, interface, and marketing efforts by the Defense Logistics Agency (DLA). We would welcome the continued assistance of your office in reviewing and providing information on the success of these initiatives. As you know, Dr. Kaminski ranks improvements to logistics systems and processes very high among his priorities. I look forward to your continued assistance in our effort to accomplish those improvements.

FOR Roy P. Willis
John F. Phillips
Deputy Under Secretary
of Defense (Logistics)

Attachment

**"We recommend that the Deputy Under Secretary of Defense (Logistics):**

**"1. Develop a plan to have requisitioning organizations make greater use of increased local procurement authority when local procurement is in the best interest of the Government. At a minimum, the implementing procedures should direct that the Military Departments establish proactive local procurement programs for centrally managed items with commercial specifications, such as items used in base maintenance, civil engineering, and related functions when local purchases of such items are in the best interests of the Government."**

This office concurs with the intent of the recommendation, and proposes an alternate method to meet the recommendation's goal of seeking expanded benefits from the increased local procurement authority in the DoD Federal Acquistion Regulation Supplement (DFARS). The increased flexibility to buy centrally managed items locally when such action is in the best interest of the Government took effect on November 30, 1995, with the publication of Defense Acquisition Circular 91-9 in the Federal Register. As a follow-up action to that publication, we have requested the Military Departments to remove restrictions on local purchase authority beyond those in the DFARS coverage from regulations issued by the Military Departments. Army, Navy, and Air Force have all contacted this office regarding their ongoing efforts to comply with this request. Implementation of these revisions will significantly increase the flexibility of local commanders to seek "best value" sources and meet the goal of this recommendation.

**"2. Direct requisitioning organizations to develop procedures to determine the total cost (materiel, transportation, and personnel costs) of a local procurement so that the organizations can evaluate whether local procurement is more cost-effective than using the central supply system."**

This office concurs with the intent of the recommendation, and proposes an alternate method to meet the recommendation's goal of lowering overall costs through the appropriate use of local purchase authority. Many reviews of the cost of accomplishing particular purchase actions have been conducted over the years, with varying results. This office views the significant recent increase in DoD use of the Government credit card as overtaking the issue of determining the cost of effecting a local purchase. As referenced in the draft report, the Purchase Card Council has reported that use of the Government credit card reduces administrative costs by $54 per transaction.

ATTACHMENT

Such a reduction serves to eliminate most or all of the additional administrative cost traditionally associated with conducting a local purchase as opposed to using the central supply system. Since the issuance of the draft report, new data have become available indicating that the Department is making significant progress in expanding use of the Government credit card. Total DoD usage of the card increased from $365 million in FY 1994 to $798 million in FY 1995. The Deputy Under Secretary of Defense (Acquisition Reform) is taking the lead to develop a DoD-wide approach to further increase use of the card. We view these actions as meeting the intent of this recommendation.

**"3. Develop a detailed strategy to address the impact of the local purchase initiatives on centralized materiel management. The strategy must consider the effects of increased local procurement on the logistics infrastructure and supply levels, competition for supplies, and inventory control point centralized procurement initiatives, such as the prime vendor program."**

This office concurs with the intent of this recommendation, and offers an alternate method for achieving its goal of ensuring that the centralized materiel management system maximize the value it adds to the DoD mission while taking into account the impact of initiatives such as acquisition reform, increased local purchase authority, and expanded use of the Government credit card. Aggressive and proactive measures by the centralized materiel management system are the most effective means of accomplishing this objective. The Defense Logistics Agency (DLA) is working with the DoD Components and the General Services Administration to initiate a program using the Government credit card as a method through which DoD activities can obtain items directly from commercial distributors at discounted prices negotiated by DLA. Such initiatives represent the appropriate response by the centralized materiel management system to the multiple challenges posed by accelerating change.

**"4. Develop procedures requiring that requisitioning organizations requisition inventory control point stocks that are in an excess supply position, unless a delay in delivery would adversely affect mission requirements, before locally procuring the items."**

This office concurs with the intent of this recommendation and offers an alternate method for achieving its goal of maximizing the use of stocks in an excess supply position. DLA is looking into expanding its marketing efforts to include broadcasting information about common-use, commercially available items of the type most likely to be purchased locally, when such items are in an excess supply position at DLA. The use of

aggressive marketing techniques, including price reductions where appropriate, will meet the intent of this recommendation.

**"5. Develop procedures to address the requisitioning organizations' reporting of demand for local procurement (contracting actions and credit card purchases) of centrally managed items and the recording and use of the demand in requirements forecasts and disposal decisions at both retail supply support organizations and inventory control points."**

This office concurs with the intent of this recommendation, and offers an alternate method for achieving its goal of ensuring that demand information on centrally managed items that are purchased locally is accumulated and utilized to the extent that such action adds value to the materiel management process. DLA is taking the lead in this area by working with its customers to improve this entire process. We view the DLA effort as meeting the intent of this recommendation.

**"6. Establish procedures for the Military Departments and the Defense Logistics Agency to use in providing feedback on the progress and economies of local procurement initiatives and any problems encountered with implementing the initiatives."**

This office concurs with the intent of this recommendation, and offers an alternate method for achieving its goal of ensuring that issues involving local procurement are resolved. As discussed in the response to recommendation 1, this office is discussing with the Military Departments their efforts to revise their regulations to grant greater flexibility to use local purchase where such action is in the best interest of the Government. We propose to continue this dialogue and offer all possible assistance in this area to the Military Departments. We view this effort as meeting the intent of this recommendation.

# Audit Team Members

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

Shelton Young
Charles Hoeger
Gordon Nielsen
Terry Wing
John Henry
James McDermott
Joseph Caucci
Lisa Durso
Joseph Girardi
Corrado Perilli