DEPARTMENT OF DEFENSE

AUDIT REPORT

SPECIAL PROGRAM REQUIREMENTS FOR LOGISTIC SUPPORT

No. 90-087

June 27, 1990

Office of the Inspector General

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

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

SUBJECT: Report on the Audit of Special Program Requirements for Logistic Support (Report No. 90-087)

This is the final report on the Audit of Special Program Requirements for Logistic Support for your information and use. Comments on a draft of this report were considered in preparing the final report. We performed the audit from October 1988 through August 1989. The overall audit objective was to determine whether SPR requests for one-time supply support sent to DoD wholesale logistics systems in advance of the need were valid. Specifically, we determined whether the forecasted requirements were for purposes cited in DoD Manual 4000.25-2-M, the quantities were valid based on records maintained by the submitter, actual requisitions were coded properly to relate them to the SPR requests, and adequate supply support was provided. We also evaluated the effectiveness of applicable internal controls. The Defense Logistics Agency (the Agency) is the principal recipient of SPR's submitted by DoD activities. In fiscal year 1988, the Agency received, and agreed to provide future supply support for, 1.1 million SPR's valued at $160 million.

The Agency provided adequate supply support in response to SPR's, but the use of SPR's as a planning method for ensuring future supply support from the Agency was usually unnecessary and frequently led to excessive investments in wholesale inventory. The Military Departments submitted SPR's for purposes not intended by the SPR program. They also did not properly code ensuing requisitions so that wholesale inventory management activities could recognize them as peculiar, nonrecurring requirements associated with SPR's and thereby discount them when making future inventory investment decisions. The adverse impact of these conditions may be magnified if management of additional items is transferred to the Agency as contemplated by a Defense

Management Review initiative. The results of our audit are summarized in the following paragraph, and the details, audit recommendations, and management comments are in Part II of this report.

The Military Departments submitted SPR's to the Agency that were unnecessary or were for excessive and unsubstantiated quantities. In addition, the Military Departments submitted requisitions that could not be readily related to the SPR's for which the supply support had been planned. In February 1988, 4 of the Agency's supply centers had about 991,000 SPR's valued at $213.6 million on file for which they had agreed to provide supply support for calendar years 1988 through 1990. We estimated that about 944,000 SPR's valued at $197.6 million should not have been submitted to the supply centers. We estimated that the supply centers will buy at least $50 million of new materiel to satisfy the SPR's, but most of the materiel will not be ordered by the Military Department activity for which the requirements had been planned. We recommended that the Military Departments and the Agency establish internal controls to adequately account for SPR investments and transactions, monitor the effectiveness of SPR's as a logistics planning method, and correct conditions identified by the monitoring (page 5).

During the course of the audit, we informed managers at various activities of conditions that we found, and they implemented corrective action immediately. The Military Departments canceled SPR's valued at $3.7 million, and the supply centers cut back procurements valued at $1.1 million.

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. There was a general lack of control procedures over all phases of the SPR program, from determination of requirements to requisition of the materiel to satisfy the requirements. The recommendations in this report, if implemented, will correct the weaknesses. We could not readily determine the monetary benefits to be realized by implementing the recommendations in this report (Appendix F). The monetary benefits were not readily identifiable because SPR's do not always cause the purchase of stock by wholesale inventory management activities. Also, when SPR's cause a purchase, the cost to DoD relating to premature or unnecessary purchasing is dependent upon the extent to which the purchases were influenced by invalid SPR requests and the assumptions as to inventory carrying costs and future requirements. A copy of this report will be provided to the senior officials responsible for internal controls within each of the Military Departments and the Agency.

The Army, the Air Force, and the Agency concurred with the finding and recommendations. For Recommendation 1.f., the Army and the Air Force did not specify their planned actions or estimated completion dates for those actions pending identification of the contents of the reports by the Agency resulting from implementation of Recommendation 2.d. We ask that the Army and the Air Force determine an appropriate implementation date and provide proposed actions and specific completion dates for Recommendation 1.f. in response to this final report. The Agency deferred implementation of Recommendation 2., until 12 months after particular contingencies are resolved. We believe the recommendation can be implemented sooner and request that the Agency reconsider its proposed time frame for implementation and provide more definite and proximate completion dates in its response to this report.

On March 20, 1990, a draft of this report was provided to the Assistant Secretary of the Navy (Financial Management). As of June 20, 1990, the Navy had not responded to the draft report. We request that the Navy respond to the final report, indicating concurrence or nonconcurrence with the finding, recommendations, and internal control weaknesses described in this report. As required by DoD Directive 7650.3, the comments should indicate concurrence or nonconcurrence in the finding and each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, please state your specific reasons. If appropriate, you may propose alternative methods for accomplishing desired improvements. We also ask that your comments indicate concurrence or nonconcurrence with the internal control weakness described above.

We request that the Agency provide comments indicating concurrence or nonconcurrence with the estimated monetary benefits, identified in Appendix F, of $1.1 million resulting from conditions that we found, and the Agency corrected, during the course of the audit. If you nonconcur with the estimated benefits or any part thereof, you must state the amount you nonconcur with and the basis for you nonconcurrence. Potential monetary benefits are subject to mediation in the event of nonconcurrence or failure to comment.

DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of the final report. Accordingly, final comments on the unresolved issues in this report should be provided within 60 days of this memorandum.

The courtesies extended to the staff during the audit are appreciated. A list of the Audit Team Members is in Appendix H. Please contact Mr. James Helfrich at our Columbus office at (614) 238-4141 (AUTOVON 850-4141) if you have any questions concerning this audit. Copies of this report are being distributed to the activities listed in Appendix I.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force

REPORT ON THE AUDIT OF SPECIAL PROGRAM REQUIREMENTS FOR LOGISTIC SUPPORT

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Prepared by:
Logistics Support Directorate
Project No. 8SS-0033

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REPORT ON THE AUDIT OF SPECIAL PROGRAM REQUIREMENTS FOR LOGISTIC SUPPORT

PART I - INTRODUCTION

Background

Major objectives of the DoD wholesale supply system are to promptly satisfy customer requirements and to maintain a minimum investment in inventory. Accomplishing those objectives depends on the wholesale inventory management activities' ability to accurately forecast future requirements. The forecasts are based on historical demand data that the inventory management activities have accumulated and advance planning data that the Military Departments' program managers and the using activities have submitted concerning future operating plans, including special programs and projects. The advance planning data relate to requirements that an inventory management activity could not anticipate and provide for if it based future inventory requirement forecasts solely on historical demand data. Special Program Requirements (SPR) represent one of the principal methods that DoD uses to arrange for future supply support from wholesale inventory management activities, especially from those in the Defense Logistics Agency (the Agency).

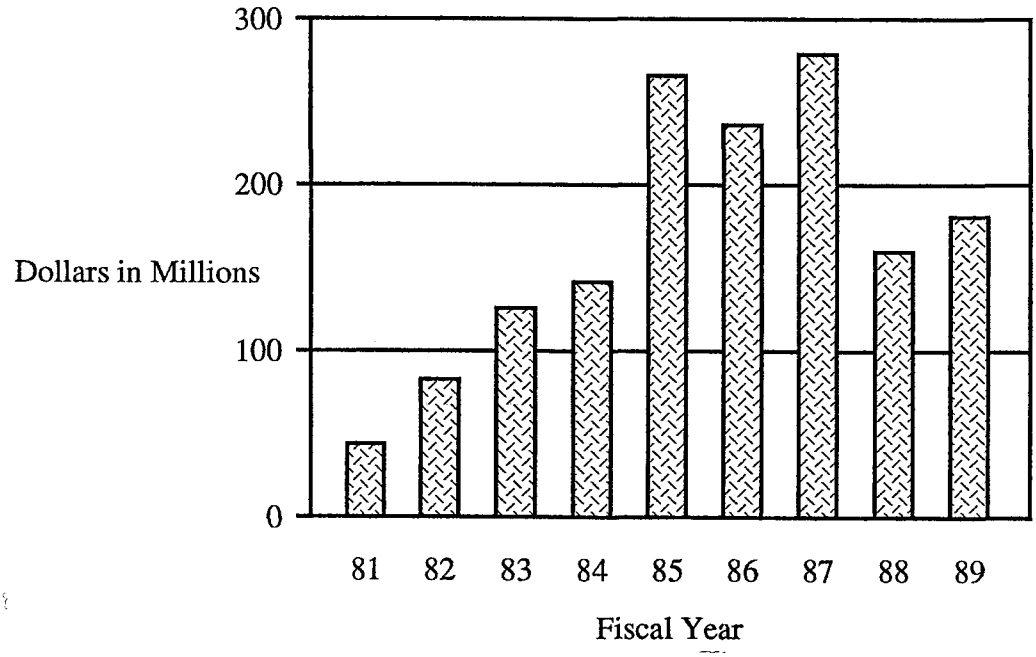
SPR is a term that DoD uses to identify unusual, nonrepetitive requirements that the Military Departments expect to materialize. The Military Departments use SPR's to plan future supply support from DoD wholesale inventory management activities. A SPR relates to supply support that will be needed at a specific date in the future (the supply support date), which can be between 90 days and 5 years after the date that the Military Department submits the SPR. On or about the specified supply support date, it is expected that the customer for whom the SPR had been planned will submit a requisition to the inventory management activity with whom the SPR had been planned, and the inventory management activity will issue the materiel. DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures," May 1987, prescribes the procedures for forecasting SPR's. The Military Departments' programming activities identify special requirements and submit a SPR request for each item for which support will be needed to the appropriate DoD wholesale inventory management activity. The principal data on a SPR request are the identity of the activity submitting the request, the item that will be needed (National Stock Number), a forecast of the quantity that will be needed, and the date the materiel will be needed. In practice, more than 95 percent of the reported SPR's are submitted to the Agency's activities.

Objectives and Scope

The overall audit objective was to determine if requests for one-time supply support sent to DoD's logistics systems in advance of the need were valid. Specifically, we determined whether the forecasted requirements were for purposes cited in DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures"; the quantities were valid based on records maintained by the submitter; actual requisitions were coded properly to relate them to the SPR requests; and adequate supply support was provided.

At the beginning of this audit, we determined that the requests received by four Agency wholesale inventory management activities represented practically all of the volume and value of SPR transactions in DoD. The volume of SPR's received by the Agency for future supply support is shown in the following chart.

Value of Support Offered for SPR's Received During Fiscal Years 1981 Through 1989



The four Agency activities that received the SPR's were the Defense Construction Supply Center, the Defense Electronics Supply Center, the Defense General Supply Center, and the Defense Industrial Supply Center. Therefore, we restricted our review to the requests that the Military Departments submitted to those supply activities.

As of February 1988, the 4 supply centers had on file 991,000 requests valued at $213.6 million[1] relating to supply support dates in calendar years 1988 through 1990. We reviewed a random sample of 359 requests valued at $14.8 million relating to 15 Military Department activities that had submitted SPR's. We evaluated procedures, controls, and documentation relating to the preparation and processing of SPR's at the submitting activities and the supply centers. For the requests in our sample that had 1988 supply support dates, we also reviewed inventory management data at the supply centers to determine whether the Military Departments had actually requisitioned the quantities of materiel for which they had requested supply support via SPR's. Where requisitions had materialized, we determined whether the Military Departments had used the proper demand code on the requisitions and whether the Agency provided adequate supply support. We concluded that the Agency provided adequate supply support in response to the SPR requests. The few instances of delayed support that we identified were attributable to contractor performance. Our sampling plan and results are discussed in Appendix A.

In this audit report, the values identified with the sample universe, individual sample transactions, and projections are based on the standard price of the items in the Federal Catalog System as of March 1989, unless otherwise noted.

This economy and efficiency audit was made from October 1988 through August 1989 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 internal controls as were considered necessary. Activities visited or contacted during the audit are shown in Appendix G.

Internal Controls

We evaluated internal controls used to ensure that DoD Components were enforcing applicable policies on SPR's and related inventory investment. We reviewed the Components' policies, procedures, and systems relating to the identification, submission, accounting, and evaluation of the effectiveness of SPR's to ensure that SPR's represented reasonable requests on the DoD wholesale supply system and did not cause unnecessary investments in wholesale inventory. The audit concluded that internal controls were not adequate because procedures and managerial controls did not ensure that SPR requests were for nonrepetitive supply support, that forecasted quantities were reasonable, that demands on requisitions related to SPR's were properly coded to associate those demands with the planning requests, and that investments in wholesale inventory to support the requests were reasonable. Details are provided in Part II of this report.

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[1] Adjusted figures. See page 17 for explanation.

Prior Audit Coverage

Office of the Assistant Inspector General, Report No. 88-140, "Requirements Forecasts on Supply Support Requests," April 27, 1988, reported that the Army submitted SPR requests that partially duplicated supply support requests. The report recommended that the Military Departments require the establishment of internal controls to ensure that the requests do not duplicate each other. Each of the Military Departments concurred with the finding and recommendation and stated that the necessary internal controls would be established to correct the problem.

PART II - FINDING AND RECOMMENDATIONS

Special Program Requirement Requests and Requisitions

Finding

The Military Departments-submitted Special Program Requirements (SPR) requests to the Defense Logistics Agency (the Agency) that were inappropriate or were for excessive and unsubstantiated quantities. In addition, the Military Departments subsequently submitted requisitions that could not be readily related to the SPR's for which the supply support had been planned. These conditions occurred because the Military Departments did not have internal controls to ensure that SPR's were submitted for appropriate purposes and reasonable quantities and that the ensuing requisitions contained the proper demand code. The conditions continued because the Military Departments and the Agency had not established internal controls to adequately account for SPR investments and transactions, monitored the effectiveness of SPR's as a logistics planning method, and initiated corrective action, as appropriate. Four of the Agency's supply centers had about 991,000 SPR's valued at $213.6 million on file for which they had agreed to provide supply support for calendar years 1988 through 1990. We estimated that about 944,000 SPR's for materiel valued at $197.6 million should not have been submitted to the supply centers, and the supply centers should not have agreed to support the SPR's. Inappropriate or overstated SPR's can cause premature and unnecessary purchases of materiel and inflated budgets by wholesale inventory management activities, but we could not develop reliable estimates of the purchase and budget amounts because of inadequate documentation. We estimated that the supply centers were buying at least $50 million of materiel for SPR's with support dates from 1988 through 1990, and most of this materiel will not be ordered by the activities for which it was planned.

DISCUSSION OF DETAILS

Background. The Military Departments' programming activities can use SPR requests to identify unusual, nonrecurring requirements for which they will need supply support. Subsequently, the Military Departments' field activities should submit requisitions for the materiel for which supply support had previously been arranged with the Agency via SPR requests. DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures," May 1987, provides guidance on the preparation and submission of SPR requests and related requisitions. The Manual indicates that there should be a great probability that SPR's will materialize as actual demands at the wholesale inventory management activity. To identify actual demands, requisitions related to SPR requests must include the demand code "P" so that the supply centers can exclude SPR related demands from the demand base that they use to forecast

future requirements and initiate purchase of additional materiel. SPR's provide a useful method of planning for future supply support from wholesale inventory management activities. When properly used, SPR's help supply centers provide timely supply support to customers and minimize wholesale inventory investments. In fiscal year 1981, SPR's represented requirements of less than $50 million. However, since fiscal year 1984, SPR's have represented requirements of over $150 million per fiscal year and several times have exceeded $200 million per fiscal year. Accordingly, SPR's represent a potentially significant factor in inventory acquisition. They also represent a substantial risk of unnecessary inventory accumulation by four of the Agency's supply centers if the Military Departments' forecasts are not reliable and actual demands cannot be related to SPR's.

The forecasted inventory availability and the inventory management activity's expectations as to whether SPR's will materialize as actual demands are major factors that determine whether an inventory management activity will buy materiel to satisfy SPR requests. One of the four supply centers had a general policy of including no more than 50 percent of the quantity of an SPR request in computing purchase requirements while the other three supply centers left the decision of how much to buy for SPR requests to the item managers. Generally, the managers at the other three Centers included 100 percent of the SPR quantities in their buy decisions; that is, they assumed that the quantity forecasted on the SPR would materialize as an actual demand in the supply system.

The four supply centers received SPR requests from hundreds of DoD activities, but most activities submitted only a small number of requests, and many requests submitted involved small dollar values. We limited our review to the SPR requests submitted by DoD activities that accounted for the largest total values of requests received by the supply centers and for which the materiel support dates were in 1988, 1989, and 1990. We expected that those activities, and the requests they submitted for support in those 3 years, were likely to have a significant influence on the supply centers' inventory acquisition and that they would provide a broad basis for evaluating the SPR process in DoD. From an adjusted sample universe of 991,000 SPR's valued at $213.6 million relating to 47 DoD field activities (see Appendix A), we reviewed 359 SPR's valued at $14.8 million that 15 DoD activities submitted to the 4 supply centers. Our sampling plan and results are discussed in Appendix A.

Submission of SPR Requests. As of February 1988, 4 Agency supply centers had on file 991,000 SPR's valued at $213.6 million[1/] that the Military Departments had submitted. The supply centers had agreed to provide supply support for the SPR's in 1988, 1989, and 1990. We estimated that 944,000 SPR's for materiel valued at $197.9 million were not valid because the SPR's either represented kinds of requirements for which the use of SPR's was not prescribed by DoD or the forecasted quantities on the SPR's were greater than historical and other substantive data could justify.

Use of SPR's. The Military Departments submitted SPR's for inappropriate purposes. Of the 359 SPR's that we reviewed, we concluded that 213 valued at $9.9 million should not have been submitted because the SPR's did not represent unusual, nonrecurring requirements. The principal purpose of 162 of the 213 SPR's was to provide for future supply support for recurring maintenance programs. Of the 162 maintenance related SPR's, Army activities submitted 51, Navy activities submitted 98, and Air Force activities submitted 13.

For example, the Army Missile Command (MICOM) submitted a SPR for six matched bevel gear sets (National Stock Number 3020-01-012-6409) to the Defense Construction Supply Center (DCSC) in February 1988 with a supply support date of October 1, 1989. In March 1989, DCSC initiated a purchase for three gear sets to satisfy half of the SPR quantity that MICOM had submitted. MICOM developed the forecast of six gear sets using an automated process that estimated recurring parts requirements for maintenance programs and generated SPR's. DoD Manual 4000.25-2-M and Army Regulation 710-1, "Centralized Inventory Management of the Army Supply System," February 1, 1988, specifically exclude the submission of SPR's for recurring requirements because the wholesale supply system can generally forecast such requirements by using an historical demand base. When we discussed the sample SPR with MICOM, we found that the Anniston Army Depot, the field activity for which the SPR had been submitted, had no need for the gear sets requested on the SPR. The Depot had been obtaining gear sets from a reclamation program and had not ordered the item from DCSC since at least March 1987. As a result of our audit, MICOM canceled three SPR's for a total of nine units valued at $58,062, and DCSC canceled a purchase request for three units valued at $19,354.

The use of SPR's for unintended purposes can, but does not necessarily, have an adverse effect on the wholesale inventory system. If the quantity forecasted on the SPR is reasonable and

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[1/] Adjusted figures. See Appendix A for original statistics and basis for adjustment.

demands are correctly coded on the ensuing requisitions, a supply center is not likely to unnecessarily acquire or accumulate inventory, even if the use of an SPR was inappropriate. However, our review indicated that quantities forecasted on SPR's were not reasonable and demands were not coded correctly on the ensuing requisitions.

Forecasted Quantities on SPR's. The quantities of materiel forecasted on SPR's were generally excessive and were not substantiated by any documentation at the Military Departments' submitting activities. Some of the activities did not have a file to identify the SPR's they had submitted. The Military Departments' procedures on submitting SPR's did not prescribe maintaining documentation to substantiate the quantities forecasted on SPR's. For most of the SPR's that the Military Departments submitted to the supply centers, extensive recordkeeping would have been inappropriate if it were viewed in terms of the potential impact of SPR's on wholesale inventory investment. Of about 1,012,000 SPR's valued at $281.8 million in our unadjusted universe (Appendix B), about 14,000 SPR's (1.4 percent) were for materiel valued at more than $2,500 with an aggregate value of $203.5 million (61.5 percent), while about 852,000 SPR's (84.2 percent) were for materiel valued at less than $100 with an aggregate value of $11.9 million (4.2 percent). Regardless of the value, about 329,000 SPR's (32.5 percent) were for a quantity of only 1 unit. Accordingly, a small percentage of SPR's represented the principal risk of unnecessary investment in wholesale inventory, while the majority of SPR's were for such small values or negligible quantities that there was little or no likelihood of significant inventory investment to satisfy such requirements. See Appendix B for more complete detail.

In the absence of records substantiating quantities at the SPR submitting activities, we relied on historical and current demand and usage data at two of the Military Department activities and the supply centers to evaluate the reasonableness of the quantities forecasted on our sample SPR's. Of the 359 SPR's valued at $14.8 million that we reviewed, we concluded that the quantities forecasted on 295 SPR's valued at $12.9 million were excessive, and the value of the excess quantities was $12.6 million.

For example, the Aviation Supply Office (ASO) submitted a SPR request in June 1987 to the Defense Industrial Supply Center for 144 retaining rings (National Stock Number 5365-01-212-0602) with a supply support date of December 1, 1989. At the time of our review, the Defense Industrial Supply Center had received, and agreed to provide support for, 3 other SPR's from ASO involving 368 more retaining rings, all with a December 1, 1989, support date. Primarily because of the 4 SPR's for 512 units, the Defense Industrial Supply Center had initiated procurements for 555 units; 350 units were on a contract and 205 units were on purchase requests.

We determined that ASO had submitted the SPR's for a nonrecurring requirement, but the quantities requested were excessive and unsubstantiated. ASO did not maintain files on SPR's that had been submitted or documentation to substantiate the reasonableness of the forecasted quantities on the requests. Based on our discussions with personnel at ASO and our review of the modification program at the North Island Naval Aviation Depot (the field activity for which our sample SPR had been submitted), most of the retaining rings were not needed because North Island would not be performing the modifications for which rings were requested, and the other planned activity had a reduced requirement for the rings. As a result of our audit, ASO canceled the sample SPR (144 units), canceled another SPR (144 units), and reduced the quantities on the other 2 SPR's from 224 units to 24 units, a total decrease of 488 units valued at $50,957. The Defense Industrial Supply Center canceled the purchase request that was in-process for 205 units valued at $21,406. The 350 units on contract could not be economically terminated. Based on the supply center's quarterly forecast demand at the time of our review, the 350 units represented about 29 years' worth of wholesale inventory requirements for retaining rings.

It is possible that some of the requirements of our sample items were reasonable at the time that the Military Departments submitted those SPR's, and that the programs for which those requirements were planned were subsequently revised. However, the lack of records in the Military Departments on the original SPR's and the lack of an audit trail to identify changes did not allow us to consider changed circumstances in forming our conclusions.

Confirmation of SPR's. The supply centers did not confirm SPR's for significant values or quantities before buying materiel to satisfy the SPR's. The Agency required the supply centers to confirm SPR's before item procurement if either the SPR value exceeded $2,500 and the quantity exceeded a monthly demand or the SPR quantity exceeded the quarterly forecast demand for a high value demand item. We did not determine whether the supply centers confirmed all the SPR's in our sample that met the value and quantity criteria because in the absence of documentation, we frequently could not determine whether the supply centers bought materiel specifically for the SPR's. However, we concluded that for 48 SPR's in our sample, the SPR quantities were unreasonable, the supply centers had bought materiel to satisfy the SPR quantities, and the SPR's met the Agency's criteria for confirmation of the SPR's before purchase. We determined that 37 of the SPR's valued at $2,773,216 had been confirmed, but 11 SPR's valued at $2,003,752 had not been confirmed. Of the 11 SPR's, 5 valued at $1,790,135 had not been confirmed because of prior agreements between a supply center and the submitting

activities not to confirm SPR's related to particular projects. We could not determine why the other 6 SPR's valued at $213,617 had not been confirmed.

The failure to confirm SPR's could have been considered an adverse condition if the process of confirming the SPR's caused the submitting activities to reevaluate the SPR's and resulted in substantial changes in quantities previously forecasted. However, the submitting activities did not maintain records on confirmations or documentation that evidenced a reevaluation of the SPR's. The submitting activities generally did not have records or documentation to substantiate the SPR's as initially submitted; consequently, they did not possess the basic information needed to reevaluate requirements and provide a substantive confirmation to the supply centers. Our review indicated that the credibility of the quantity on a SPR did not vary substantially, regardless of whether a supply center confirmed a SPR. For the 37 SPR's valued at $2,773,216 that we determined had been confirmed, we concluded that quantities valued at $2,753,434 (99.3 percent) were unnecessary. Of the 11 SPR's valued at $2,003,752 that we determined had not been confirmed, we concluded that quantities valued at $2,003,752 (100 percent) were unnecessary.

Requisitions Related to SPR Requests. Future requirements that the Military Departments planned for supply support from the supply centers via SPR's either did not or were not likely to materialize as actual requisitions for the forecasted quantities. In our sample of 359 SPR's, there were 134 SPR's valued at $6.0 million for which the supply support dates had passed by at least 60 days by April 1, 1989. About 90 percent of the value was related to 44 SPR's with forecasted requirements of $25,000 or more (totaling $5.4 million). We could not form an opinion on demands related to 8 (valued at $442,000) of the 44 SPR's because we could not determine from records or discussions at the SPR submitting activity the identity of the planned users and therefore could not determine whether planned users had submitted requisitions. For the other 36 SPR's, we determined that within 60 days of the planned support date, the supply centers received no demands from the planned users for materiel related to 25 SPR's valued at $4,350,000. The supply centers received only $181,000 in demands from the planned users of materiel related to the other 11 SPR's valued at $623,000.

The supply centers' demand summary records indicated that none of the $181,000 in demands that had been received had been coded by the requisitioners with the correct type of demand code, "P." Because of time constraints and smaller values, we did not examine the supply centers' detailed files to identify requisxons that might have been received for the other 90 of the 134 sample SPR's. However, we reviewed the supply centers' demand summary records for the items on 63 (valued at $409,500) of the 90 SPR's and found that "P" coded demands (valued at about $4,800) had

been received for only 4 of the 63 SPR's within 60 days of the planned support dates. A prerequisite for submitting SPR requests is that there be a high probability that demands will actually materialize; that is, the activities for whom the SPR's were planned will submit requisitions for the forecasted quantities to the wholesale inventory management activities. Our review indicated that there was a low probability that demands, approximating the quantities forecasted on the SPR's, would materialize and, if they did materialize, that they would be readily identifiable with the appropriate SPR's and properly considered in future inventory procurement and retention decisions.

Whether actual demands for requirements that had previously been planned via SPR's materialized was not readily apparent from the supply centers' records or DoD's collective records because an SPR, and the subsequent requisition(s) related to the SPR, are usually not positively linked. The principal means of associating supply management transactions in DoD is through a document number, but the Military Departments did not employ that or any other means of associating a particular SPR with a related requisition. There was no correlation because the SPR bears the document number of the submitting activity while the related requisition bears the document number of the using activity, which is generally not the same as the submitting activity. Accordingly, the association of actual demands with requirements that had been forecasted previously on SPR's could not be made without substantial effort, and our audit disclosed that the DoD Components did not make such an effort. Consequently, the recognition of SPR related demands by a supply center was largely dependent on the presence of the demand code "P" in the requisition submitted by the using activity.

Supply centers separately accounted for demands that were coded "P" and did not include them in the demand base that was used to forecast future requirements. Because the "P" coded demands were discounted, inventory was not purchased in anticipation of similar demands in the future. However, when a "P" code is not on SPR related requisitions, investments in inventory by the supply center could be adversely affected.

For example, the San Antonio Air Logistics Center submitted an SPR to the Defense Electronics Supply Center (DESC) in August 1986 for 280 electric connector plugs (National Stock Number 5935-00-054-2499) with a supply support date of October 1, 1989. DESC also had on file SPR's for 336 additional plugs with support dates in fiscal years 1988 and 1989 from the San Antonio Air Logistics Center for a total requirement of 616 plugs. The SPR's had a valid purpose, but the related requisitions were not properly demand coded, which caused unnecessary purchase of wholesale inventory. The sample SPR for 280 units and the SPR's for 336 units were for materiel to be used for nonrecurring maintenance on the T38 aircraft at Randolph

Air Force Base. Supply records at Randolph showed that use of this item was consistent with the SPR quantities and therefore the forecasts were reasonable. However, the inventory management records at DESC did not show that requisitions received from Randolph contained the demand code "P" to associate the demands with SPR's. Supply personnel at Randolph advised us that the demands on requisitions relating to that repair program had not been coded as "P." As a result, the demands were not excluded from the historical demand base that DESC used to forecast future requirements and to buy materiel to satisfy forecasted requirements. Randolph's future requirements for this item could be satisfied from inventory that DESC already had on order because the on-order quantity reflected Randolph's prior demands that were not, but should have been, coded "P." Because of this improper coding on the requisitions, the quantity of 280 that was requested on the most recent SPR became excessive to requirements. The San Antonio Air Logistics Center canceled the SPR for 280 units (and also SPR's related to other items in that repair program) and DESC reduced a procurement that was in-process by 185 units valued at $18,831.

SPR's and Inventory Investment. Although SPR's can influence the amount that the Agency invests in providing future supply support, there was no systematic accounting for the amounts that the supply centers spent to purchase inventory to satisfy SPR's or for the demands that actually materialized as related to the SPR's. Consequently, there was no basis for the Agency to periodically evaluate the effectiveness of inventory investments to satisfy SPR's, and there was no feedback to the Military Departments on the reliability of the forecasted quantities on the SPR's that caused inventory investments. Essentially, neither the Military Departments nor the Agency had internal controls over the SPR supply support process.

In the absence of specific accounting for SPR related inventory purchases and adequate documentation at the supply centers, we could not positively establish how much inventory was purchased to satisfy the SPR's in our sample. Accordingly, we could not determine how much the supply centers were spending unnecessarily or prematurely to acquire inventory to accommodate invalid SPR requests. However, we believe the amount was considerable. For the 295 SPR's valued at $12.9 million for which we concluded that the quantities on the SPR's were unreasonable, we examined item management files at the supply centers to determine whether the supply centers had purchased, or were in the process of purchasing, inventory to satisfy the SPR's. For 94 SPR's valued at $5,383,000, we concluded that the supply centers bought, or were buying, materiel valued at $4,593,000 to satisfy those SPR's. Based on the purchases for the 94 SPR's, we estimated that the supply centers bought, or will buy, at least $50 million of materiel for SPR's with support dates in 1988, 1989, and 1990, and that most of this materiel would not be ordered by the activities for which it was planned.

We could not determine whether materiel was being purchased for 65 SPR's valued at $1,899,000 because of a lack of records. For another 120 SPR's valued at $5,445,000, we concluded that the supply centers either did not or would not have to buy inventory specifically to satisfy those SPR's because the supply centers had sufficient stock on hand or due in to accommodate 82 SPR's valued at $2,495,000 or support was contingent on receipt of a funded requisition (38 SPR's for $2,950,000). For another 16 SPR's valued at $184,000, the support date was beyond the procurement lead time and therefore it was too early to determine whether the supply centers would buy materiel for those SPR's.

Conclusion. SPR's represent a useful method of arranging for future support from the supply centers. However, if the Military Departments and the Agency do not improve the credibility of the SPR's that are submitted, properly link actual demands to SPR's, account for inventory investments prompted by SPR's, and periodically assess the effectiveness of the SPR's, the risk to DoD of unnecessary inventory acquisition and accumulation by the supply centers because of SPR's will continue to be substantial. Moreover, DLA faces the likelihood of further growth in inapplicable inventories if the management of substantial numbers of consumable items is transferred from the Military Departments to DLA as part of the Defense Management Review initiatives. Such a transfer could result in DLA receiving many SPR's from the Military Departments' activities for the newly managed items and accepting considerable risk in inventory investment to satisfy those SPR's if the credibility of, and controls over, SPR's do not improve.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Assistant Secretary of the Army (Installations, Logistics and Environment), the Assistant Secretary of the Navy (Research, Development and Acquisition), and the Assistant Secretary of the Air Force (Research, Development and Logistics) establish internal controls relating to Special Program Requirements requests to include an assessment of the:

a. Necessity for the submission of Special Program Requirements requests to the Defense Logistics Agency.

b. Reasonableness of the quantities forecasted.

c. Adequacy and retention of documentation supporting requests.

d. Timely and accurate reporting of significant changes to requirements.

e. Accuracy of demand coding (that is, "P" coded) on requisitions related to Special Program Requirements.

f. Actions taken by submitting activities in response to periodic reporting on Special Program Requirements effectiveness by the Defense Logistics Agency.

2. We recommend that the Director, Defense Logistics Agency, establish internal controls to ensure that investment in inventory to support Special Program Requirements is kept to a minimum. These controls should include:

a. A separate accounting for purchases of inventory related to support of Special Program Requirements. Purchases of $2,500 or more (at standard price) might be an appropriate minimum for such accounting.

b. Maintenance of historical records for the particular Special Program Requirements requests, especially for those that caused the purchase of materiel.

c. A comparison of actual demands received with the quantities forecasted on the Special Program Requirements that resulted in the purchase of materiel.

d. Periodic reporting to the Military Departments on the Special Program Requirements for which less than 80 percent of the forecasted requirements materialized as actual demands.

MANAGEMENT COMMENTS

The Army and the Air Force concurred with the finding and Recommendation 1. For Recommendation 1.f., to establish internal controls to assess actions taken by submitting activities in response to periodic reporting on SPR effectiveness by the Agency, the Army and Air Force said that their specific actions will depend on the content of the Agency's effectiveness reports. The full text of the Army's response is in Appendix C and the full text of the Air Force's response is in Appendix D.

The Agency concurred with the finding and Recommendation 2. The Agency stated that it would implement Recommendation 2. within 12 months after the Military Departments establish the internal controls in Recommendation 1. and DoD establishes a system or technique that links SPR's with related requisitions. The Agency also concurred that there was an internal control weakness in the SPR process, but did not believe the weakness was material. The full text of the Agency's response is in Appendix E.

The Navy was provided a copy of the draft of this report on March 20, 1990, but had not provided a response as of June 11, 1990.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

We ask that the Army and the Air Force coordinate with DLA to provide a more definite reply as to the time and nature of proposed actions on implementation of Recommendation 1.f. in their responses to this final report.

We believe that the Agency's proposal to defer implementation of Recommendation 2. until 12 months after the occurrence of the cited contingencies is not reasonable or necessary and could result in substantial avoidable waste in inventory investments. Accordingly, we request that the Agency reconsider its proposed time frame for implementation of Recommendation 2. and provide more definite and proximate implementation dates in its response to this final report. Regarding the assessment of internal control weaknesses on SPR's, we do not share the Agency's view that the weakness is not material. DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, provides the criteria for assessing materiality of internal control weaknesses. Two of the criteria are that problems should appear in more than one DoD Component and the problems should amount to $2 million or more. As shown in this report, the problems with SPR's involve four DoD Components: Army, Navy, Air Force, and the Agency. Also, the Agency bought, or will buy, at least $50 million of materiel to satisfy SPR's (page 13) and most of this materiel will not be requisitioned by the activities for which the materiel was being bought. Accordingly, we concluded that the internal control weakness relating to SPR's was material. However, we do agree that the responsibility for the weakness belongs to all DoD activities, not solely to the Agency.

STATISTICAL SAMPLING PLAN AND RESULTS

Special Program Requirements (SPR's) for future supply support by the Defense Logistics Agency (the Agency) were maintained in computer files at the Agency's four hardware supply centers. As of February 1988, those files contained about 1,643,000 SPR's valued at $406 million relating to 705 DoD activities needing supply support from 1988 to 1993. We limited our review to a sample universe of about 1,012,000 SPR's valued at $281.8 million (Appendix B). That sample universe represented SPR's from 47 Army, Navy, and Air Force activities, each of which had submitted SPR's with an aggregate value of more than $500,000 for supply support from the Agency in the 5-year period. In total, the 47 activities accounted for about 75 percent of the number and 86 percent of the value of SPR's with 1988, 1989, and 1990 supply support dates. We excluded about 631,000 SPR's valued at $124 million from our sample universe because they were from activities that submitted SPR's with aggregate values of less than $500,000 or they had supply support dates after 1990 and therefore were more susceptible to change and less likely to influence near term wholesale inventory management decisions.

We used a multistage sampling plan that incorporated both stratified and cluster sampling methodologies. Our total sample was 359 SPR's valued at $14.8 million that were initiated by 15 DoD activities. The sample was comprised of 309 SPR's for which the Agency had advised the submitting activities that it would provide unconditional supply support (102 in 1988 and 207 in 1989 and 1990) and 50 SPR's for which the Agency had advised the submitting activities that it would provide supply support only upon receipt of a funded requisition. We projected our sample results to an adjusted sample universe of 991,000 SPR's valued at $213.6 million. We adjusted the original sample universe of 1,012,000 SPR's valued at $281.8 million to reflect the uniform pricing that we adopted for unit prices of identical stock numbers (-$37.6 million) and to recognize quantitative modifications (-$15.2 million), cancellations (-21,000 SPR's valued at $12.1 million), and item management transfers (-$3.3 million) that we estimated to have occurred in the sample universe after our February 1988 cutoff. The sample results were projected with a 95-percent confidence level and a sampling precision of ± .05 percent for attributes and ± 10.64 percent for dollars. We estimated that about 944,000 SPR's valued at $197.9 million that had been submitted to the 4 supply centers were not valid because they represented requirements for which the use of SPR's was not prescribed or were for greater quantities of materiel than historical and other substantive data could justify.

STATISTICAL SAMPLING PLAN AND RESULTS (continued)

Sample Size by Activity

Submitting Activity	SPR's Sampled Number	SPR's Sampled Value
Army		
Missile Command	10	$ 177,461
Armament, Munitions and Chemical Command	36	1,768,029
Aviation Systems Command	16	554,885
Tank-Automotive Command	24	377,499
Navy		
Aviation Supply Office	78	7,496,868
Submarine Base	12	277,563
Ordnance Station	36	536,846
Supply Center, Oakland	17	232,137
Supply Center, Norfolk	13	164,853
Undersea Warfare Engineering Station	12	197,874
USS Enterprise	10	138,697
Air Force		
International Air Logistics Center	9	24,130
Oklahoma City Air Logistics Center	24	371,196
San Antonio Air Logistics Center	18	347,552
Warner Robins Air Logistics Center	44	2,171,974
Total	359	$14,837,564

SUMMARY OF SAMPLE UNIVERSE OF SPECIAL PROGRAM REQUIREMENTS REQUESTS BY VALUE AND MINIMUM QUANTITY

AS OF FEBRUARY 1988

CATEGORY	1988	1989	1990	Total	Percent*
		($ MILLIONS)			
A. Total					
Number of Requests	531,954	317,494	162,493	1,011,941	
Extended Dollar Value	$98.8	$111.7	$71.4	$281.8	
Requests for a Quantity of One Unit	164,811	105,402	58,527	328,740	32
B. Extended Value Greater Than $25,000					
Number of Requests	356	497	362	1,215	
Extended Dollar Value	$27.8	$57.5	$35.5	$120.8	
Requests for a Quantity of One Unit	0	5	5	10	1
C. Extended Value of Request $10,000 - $25,000					
Number of Requests	785	785	566	2,136	
Extended Dollar Value	$11.8	$11.9	$8.4	$32.1	
Requests for a Quantity of One Unit	11	3	4	18	1
D. Extended Value of Request $2,500 - $10,000					
Number of Requests	4,533	3,692	2,498	10,723	
Extended Dollar Value	$21.0	$17.6	$12.0	$50.6	
Requests for a Quantity of One Unit	484	190	137	811	8
E. Extended Value of Request $1,000 - $2,500					
Number of Requests	8,198	5,600	3,679	17,477	
Extended Dollar Value	$12.7	$8.7	$5.7	$27.1	
Requests for a Quantity of One Unit	1,317	813	525	2,655	15
F. Extended Value of Request $500 - $1,000					
Number of Requests	11,033	7,010	4,453	22,496	
Extended Dollar Value	$7.7	$4.9	$3.1	$15.7	
Requests for a Quantity of One Unit	1,988	1,110	753	3,851	17
G. Extended Value of Request $100 - $500					
Number of Requests	52,976	33,198	19,826	106,000	
Extended Dollar Value	$11.8	$7.4	$4.4	$23.6	
Requests for a Quantity of One Unit	10,994	7,046	5,217	23,257	22
H. Extended Value of Request $50 - $100					
Number of Requests	36,706	22,287	12,913	71,906	
Extended Dollar Value	$2.6	$1.6	$.9	$5.1	
Requests for a Quantity of One Unit	8,857	5,742	4,060	18,659	26
I. Extended Value of Request $10 - $50					
Number of Requests	112,476	69,272	38,738	220,486	
Extended Dollar Value	$2.7	$1.7	$.97	$5.37	
Requests for a Quantity of One Unit	30,359	19,822	13,077	63,258	29

SUMMARY OF SAMPLE UNIVERSE OF SPECIAL PROGRAM REQUIREMENTS REQUESTS BY VALUE AND MINIMUM QUANTITY (continued)

AS OF FEBRUARY 1988

CATEGORY	1988	1989	1990	Total	Percent*
		($ MILLIONS)			
J. Extended Value of Request $5 - $10					
Number of Requests	55,103	32,738	16,586	104,427	
Extended Dollar Value	$.4	$.24	$.12	$.76	
Requests for a Quantity of One Unit	15,267	10,161	6,013	31,441	30
K. Extended Value of Request $1 - $5					
Number of Requests	134,616	70,675	34,107	239,398	
Extended Dollar Value	$.33	$.18	$.087	$.597	
Requests for a Quantity of One Unit	44,324	23,916	13,859	82,099	34
L. Extended Value Up To $1					
Number of Requests	115,169	71,739	28,765	215,673	
Extended Dollar Value	$.049	$.028	$.011	$.088	
Requests for a Quantity of One Unit	51,207	36,593	14,877	102,677	48
M. Extended Value of Request $0					
Number of Requests	3	1	0	4	
Extended Dollar Value	$0	$0	$0	$0	
Requests for a Quantity of One Unit	3	1	0	4	100

* Represents the portion of Requests for a Quantity of One Unit expressed to the Number of Requests in the category.

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

DALO-SMP 90002266 29 MAY 1990

COL MCCOY/EXECUTIVE/79039

MEMORANDUM THRU ~~DEPUTY CHIEF OF STAFF FOR LOGISTICS~~ 30 MAY 1990
~~DIRECTOR OF THE ARMY STAFF~~ FOR J.P. DONNELLY LTC GS ADAS 6/1/90
ASSISTANT SECRETARY ~~OF THE ARMY (INSTALLATIONS~~
LOGISTICS AND ENVIRONMENT) Eric P. Orsini
Deputy Assistant Secretary of the Army (Logistics)
OASA (I&L)

FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Report on the Audit of Special Program Requirements (Project No. 8SS-0033), March 20, 1990--INFORMATION MEMORANDUM

1. This is in response to DoDIG memorandum dated March 20, 1990 which requested Army review and comments to subject draft report (Tab A).

2. The Army concurs with all findings and recommendations. Our detailed comments are at Tab B.

2 Encls

JACKSON E. ROZIER, JR.
Major General, GS
Director of Supply
and Maintenance

CF:
SAIG-PA
Cdr, AMC, AMCIR-A/AMCSM-MSM

OASA(IL&E) - Concur, Mr. Croom/X75727 (Conference)

MAJ Gordon/X77061

DoDIG FINDINGS, RECOMMENDATIONS AND ARMY COMMENTS
(PROJECT NO. 8SS-0033)

FINDING: The Military Departments submitted Special Program Requirements (SPR) requests to the Defense Logistics Agency (the Agency) that were inappropriate or were for excessive and unsubstantiated quantities. In addition, the Military Departments subsequently submitted requisitions that could not be readily related to the SPRs for which the supply support had been planned. These conditions occurred because the Military Departments did not have internal controls to ensure that SPRs were submitted for appropriate purposes and reasonable quantities and that the ensuing requisitions contained the proper demand code. The conditions continued because the Military Departments and the Agency had not established internal controls to adequately account for SPR investments and transactions, monitored the effectiveness of SPRs as a logistics planning method, and initiated corrective action, as appropriate. Four of the Agency's supply centers had about 991,000 SPRs valued at $213.6 million on file for which they had agreed to provide supply support for calendar years 1988 through 1990. We estimated that about 944,000 SPRs for materiel valued at $197.9 million should not have been submitted to the supply centers, and the supply centers should not have agreed to support the SPRs. Inappropriate or overstated SPRs can cause premature and unnecessary purchases of materiel and inflated budgets by wholesale management activities, but we could not develop reliable estimates of the purchase and budget amounts because of inadequate documentation. We estimated that the supply centers were buying at least $50 million of materiel for SPRs with support dates from 1988 through 1990, most of this materiel will not be ordered by the activities for which it was planned and will add to the Agency's inapplicable inventory balances.

COMMENT: Concur.

RECOMMENDATION: We recommend that the Assistant Secretary of the Army (Installations and Logistics), the Assistant Secretary of the Navy (Shipbuilding and Logistics), and the Assistant Secretary of the Air Force (Research, Development and Logistics) establish internal controls relating to Special Program Requirements requests to include an assessment of the:

a. Necessity for the submission of Special Program Requirements requests to the Defense Logistics Agency.

b. Reasonableness of the quantities forecasted.

c. Adequacy and retention of documentation supporting requests.

d. Timely and accurate reporting of significant changes to requirements.

e. Accuracy of demand coding (that is, "p" coded) on requisitions related to Special Program Requirements.

f. Actions taken by submitting activities in response to periodic reporting on Special Program Requirement effectiveness by the Defense Logistics Agency.

COMMENTS: Concur. The majority of the dollar value of Army Materiel Command SPRs to DLA are in support of Army depot maintenance. AMC will task DESCOM, NLT 1 Jun 90, to initiate an assessment of DLA support to Army depot maintenance programs. The assessment will address need for SPRs and reasonableness of quantities forecasted.

Army special program requirement policy is clearly articulated in AR 710-1. This regulation provides Army guidance on item manager retention of SPR forecasts, as well as SPR submission, modification and cancellation. The Army Materiel Command will reiterate to all Army inventory control points (ICP), NLT 1 Jun 90, that SPR policy contained in AR 710-1 is mandatory and will be strictly followed.

Systems Change Request (SCR) XSMIRA707102, Apr 87, directed the Standard Depot System to automatically code all project code "ZCN" requisitions with demand code "p". This SCR was implemented in Nov 88. Following implementation, a minor problem was discovered and SCR XLSGIA924400, implemented in Sep 89, corrected the problem.

We will need to see what information will be contained in the proposed DLA effectiveness reports before we can determine specific Army actions.

DEPARTMENT OF THE AIR FORCE
WASHINGTON, D.C. 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

15 MAY 1990

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

SUBJECT: DoD(IG) Draft Report on the Audit of Special Program Requirements (Project 8SS-0033), (Your Memo, March 20, 1990) - INFORMATION MEMORANDUM

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

We concur with findings and recommendations and have provided our comments on the attached. We appreciate the opportunity to reply to the draft report.

LLOYD K. MOSEMANN, II
Deputy Assistant Secretary
(Logistics)

1 Atch
Management Comments

DRAFT REPORT OF AUDIT
SPECIAL PROGRAM REQUIREMENTS

RECOMMENDATION: We recommend that the Assistant Secretary of the Air Force (Research, Development and Logistics) establish internal controls relating to Special Program Requirements requests to include an assessment of the:

a. Necessity for the submission of SPR requests to the Defense Logistics Agency.

b. Reasonableness of the quantities forecasted.

c. Adequacy and retention of documentation supporting requests.

d. Timely and accurate reporting of significant changes to requirements.

e. Accuracy of demand coding (that is, "P" coded) on requisitions related to Special Program Requirements.

f. Actions taken by submitting activities in response to periodic reporting on Special Program Requirements effectiveness by Defense Logistics Agency.

MANAGEMENT COMMENTS: Concur with intent.

A system change request was initiated in May 1989 to automate the Special Program Requirement (SPR) process. The process, scheduled for implementation in December, 1990, will maintain SPR document history, edit transactions, and provide management notices to support the recommendation, especially 1.d, 1.e, and 1.f.

The policy contained in Air Force Manual 67-1, Volume I, part One, Chapter 11, Section W, will be revised by December 1990 to coincide with the system change. An Interim Change Notice has been issued to specify this policy until the formal notice is issued. It instructs activities to establish internal controls related to SPR requests as recommended by 1.a, 1.b, and 1.c. The controls require verification of SPR request criteria and the quantities requested. In addition, the policy requires that adequate documentation must be prepared and maintained to substantiate the need and quantity of the request.

The Air Force concurs with the intent of subparagraph 1.f, but will require specifics on what the periodic reporting by the Defense Logistics Agency will consist of before the Air Force can determine what form and content the responses will take.

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

16 MAY 1990

IN REPLY REFER TO DLA-CI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE
ATTN: Director, Logistics Support Directorate

SUBJECT: Report on the Audit of Special Program Requirements (Project NO. 8SS-0033)

Enclosed are our comments to the draft report which is in response to your memorandum dated 20 Mar 90.

5 Encls

Reathea E. Holmes
REATHEA E. HOLMES
Chief, Internal Review Division
Office of Comptroller

cc:
OASD(P&L) Randy Fowler

FORMAT 1 OF 5

TYPE OF REPORT: AUDIT DATE OF POSITION: 15 May 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Audit of Special Program Requirements (Project No. 8SS-0033)

FINDING: The Military Departments submitted Special Program Requirements (SPR) requests to the Defense Logistics Agency (the Agency) that were inappropriate or were for excessive and unsubstantiated quantities. In addition, the Military Departments subsequently submitted requisitions that could not be readily related to the SPRs for which the supply support had been planned. These conditions occurred because the Military Departments did not have internal controls to ensure that SPRs were submitted for appropriate purposes and reasonable quantities and that the ensuring requisitions contained the proper demand code. The conditions continued because the Military Departments and the Agency had not established internal controls to adequately account for SPR investments and transactions, monitored the effectiveness of SPRs as a logistics planning method, and initiated corrective action, as appropriate. Four of the Agency's supply centers had about 991,000 SPRs valued at $213.6 million on file for which they had agreed to provide supply support for calendar years 1988 through 1990. We estimated that about 944,000 SPRs for materiel valued at $197.9 million should not have been submitted to the supply centers, and the supply centers should not have agreed to support the SPRs. Inappropriate or overstated SPRs can cause premature and unnecessary purchases of materiel and inflated budgets by wholesale inventory management activities, but we could not develop reliable estimates of the purchase and budget amounts because of inadequate documentation. We estimated that the supply centers were buying at least $50 million of materiel for SPRs with support dates from 1988 through 1990, most of this materiel will not be ordered by the activities for which it was planned and will add to the Agency's inapplicable inventory balances.

DLA COMMENTS: Concur with the finding, however, we cannot confirm your estimate of $50 million supply center purchases. The audit stated that reliable estimates of the purchase and budget amounts could not be determined due to inadequate documentation. In addition, based on an informal request from HQ DLA, one of our Supply Centers, Defense General Supply Center (DGSC), was asked to conduct an in-depth evaluation of the SPR program. From the DGSC report of Sep 89, we were able to construct a profile of the types of items that receive SPRs and the impact of the SPR quantity. Those profiles suggest that most SPRs have insignificant impact on the forecast process because the quantities they reflect are small compared to the demand rate of the affected NSN. Also, our internal evaluation indicates the majority of SPRs are low quantities which do not impact procurement nor add to DLA's inapplicable inventory balances. As stated in Recommendation 2.a., to reduce risks of over investments, in Aug and Nov 88, the Supply Centers were provided guidance and have implemented the procedures to revise the acceptance criteria for SPRs. In Mar 90, additional program changes were identified to DSAC that will mechanically reduce risks of over investments. These changes include revising the acceptance of the support date from five to two years; rejecting change transactions if there is no matching document number in the SPR trailer; and for SPRs

that are accepted, comparing the SPR quantity to the item's procurement cycle quantity or 1/2 the Numeric Stockage Objective (NSO) quantity to determine the need for the additive forecast requirement. Concur with the internal control weakness cited; however, the weakness is not considered material based on above comments.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Nancy Bennett, DLA-OSR, x46132, 19 Apr 90

DLA APPROVAL: Helen T. McCoy

FORMAT 2 OF 5

TYPE OF REPORT: AUDIT DATE OF POSITION: 15 May 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Audit of Special Program Requirements (Project No. 8SS-0033)

RECOMMENDATION 2.a.: We recommend that the Director, Defense Logistics Agency, establish internal controls to ensure that investment in inventory to support Special Program Requirements is kept to a minimum. These controls should include a separate accounting for purchases of inventory related to support of Special Program Requirements. Purchases of $2,500 or more (at standard price) might be an appropriate minimum for such accounting.

DLA COMMENTS: Concur with recommendation. DLA implementation will occur 12 months after completion of the following: (1) Implementation by the Military Services of actions defined by Recommendation #1. Until the Military Services establish internal controls defined in Recommendation #1, DLA's capability in today's environment to track is based on an after the fact analysis that looks back and attempts to analyze/determine what happened. (2) Implementation by the MILS group responsible for DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures," May 1987, of a system or technique that links SPRs and related requisitions together. In Aug and Nov 88 to reduce risks of over investments, the Supply Centers were provided guidance and have implemented the procedures to revise the acceptance criteria for SPRs. In Mar 90, additional program changes were identified to DSAC that will mechanically reduce risks of over investments. These changes include revising the acceptance of the support date from five to two years; rejecting change transactions if there is no matching document number in the SPR trailer; and for SPRs that are accepted, comparing the SPR quantity to the item's procurement cycle quantity or 1/2 the NSO quantity to determine the need for the additive forecast requirement. Concur with the internal control weakness cited; however, the weakness is not considered material based on above comments.

DISPOSITION:
(X) Action is ongoing; Final Estimated Completion Date: 12 months after Military Services implement Recommendation #1.

( ) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Nancy Bennett, DLA-OSR, x46132, 19 Apr 90

DLA APPROVAL: Helen T. McCoy

FORMAT 3 OF 5

TYPE OF REPORT: AUDIT DATE OF POSITION: 15 May 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Audit of Special Program Requirements (Project No. 8SS-0033)

RECOMMENDATION 2.b.: We recommend that the Director, Defense Logistics Agency, establish internal controls to ensure that investment in inventory to support Special Program Requirements is kept to a minimum. These controls should include maintenance of historical records for the particular Special Program Requirements requests, especially for those that caused the purchase of materiel.

DLA COMMENTS: Concur with recommendation. DLA implementation will occur 12 months after completion of the following: (1) Implementation by the Military Services of actions defined by Recommendation #1. Until the Military Services establish internal controls defined in Recommendation #1, DLA's capability in today's environment to track is based on an after the fact analysis that looks back and attempts to analyze/determine what happened. (2) Implementation by the MILS group responsible for DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures," May 1987, of a system or technique that links SPRs and related requisitions together. Concur with the internal control weakness cited; however, the weakness is not considered material based on above comments.

DISPOSITION:
(X) Action is ongoing; Final Estimated Completion Date: 12 months after Military Services implement Recommendation #1.

( ) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Nancy Bennett, DLA-OSR, x46132, 19 Apr 90

DLA APPROVAL: Helen T. McCoy

FORMAT 4 OF 5

TYPE OF REPORT: AUDIT DATE OF POSITION: 15 May 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Audit of Special Program Requirements (Project No. 8SS-0033)

RECOMMENDATION 2.c.: We recommend that the Director, Defense Logistics Agency, establish internal controls to ensure that investment in inventory to support Special Program Requirements is kept to a minimum. These controls should include a comparison of actual demands received with the quantities forecasted on the Special Program Requirements that resulted in the purchase of materiel.

DLA COMMENTS: Concur with recommendation. DLA implementation will occur 12 months after completion of the following: (1) Implementation by the Military Services of actions defined by Recommendation #1. Until the Military Services establish internal controls defined in Recommendation #1, DLA's capability in today's environment to track is based on an after the fact analysis that looks back and attempts to analyze/determine what happened. (2) Implementation by the MILS group responsible for DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures," May 1987, of a system or technique that links SPRs and related requisitions together. Concur with the internal control weakness cited; however, the weakness is not considered material based on above comments.

DISPOSITION:

(X) Action is ongoing; Final Estimated Completion Date: 12 months after Military Services implement Recommendation #1.

( ) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Nancy Bennett, DLA-OSR, x46132, 19 Apr 90

DLA APPROVAL: Helen T. McCoy

FORMAT 5 OF 5

TYPE OF REPORT: AUDIT DATE OF POSITION: 15 May 90

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NUMBER: Audit of Special Program Requirements (Project No. 8SS-0033)

RECOMMENDATION 2.d.: We recommend that the Director, Defense Logistics Agency, establish internal controls to ensure that investment in inventory to support Special Program Requirements is kept to a minimum. These controls should include periodic reporting to the Military Departments on the Special Program Requirements for which less than 80 percent of the forecasted requirements materialized as actual demands.

DLA COMMENTS: Concur with recommendation. DLA implementation will occur 12 months after completion of the following: (1) Implementation by the Military Services of actions defined by Recommendation #1. Until the Military Services establish internal controls defined in Recommendation #1, DLA's capability in today's environment to track is based on an after the fact analysis that looks back and attempts to analyze/determine what happened. (2) Implementation by the MILS group responsible for DoD Manual 4000.25-2-M, "Military Standard Transaction Reporting and Accounting Procedures," May 1987, of a system or technique that links SPRs and related requisitions together. Concur with the internal control weakness cited; however, the weakness is not considered material based on above comments.

DISPOSITION:
(X) Action is ongoing; Final Estimated Completion Date: 12 months after Military Services implement Recommendation #1.

( ) Action is considered complete.

MONETARY BENEFITS: None.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE BENEFITS REALIZED:

ACTION OFFICER: Nancy Bennett, DLA-OSR, x46132, 19 Apr 90

DLA APPROVAL: Helen T. McCoy

REPORT OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1. and 2.	Economy and Efficiency. Avoid unnecessary or premature purchases of wholesale inventory by minimizing the use of Special Program Requirements (SPR's), improving the reliability of quantitative forecasts on SPR's, and properly coding the type of demand on requisitions related to SPR's.	The benefit is primarily one of cost avoidance, but the amount is not readily determinable. For FY's 1988, 1989, and 1990, we estimated that the Defense Logistics Agency (the Agency) agreed to provide supply support for 991,000 SPR's valued at $213.6 million. We estimated that 944,000 SPR's valued at $197.9 million were invalid. We could not determine with any precision the cost that the Agency could avoid by not acquiring inventory to satisfy the invalid SPR's. Adequate records were not available to enable us to develop a reliable estimate of the amount of materiel that the Agency would buy specifically to satisfy SPR quantities, how much of those forecasted requirements would not materialize as actual demands, and when materiel that was needlessly acquired for SPR's would be issued.
Not applicable	Economy and efficiency. Avoid unnecessary purchase of wholesale inventory.	$1.1 million in one-time cost avoidance . The supply centers curtailed purchases in-process during the audit in response to our evaluation of the validity of requirments forcasted on SPR's.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics), Defense Logistics Initiatives Division, Washington, DC
Assistant Secretary of Defense (Production and Logistics), Defense Logistics Standards Systems Division, Washington, DC

Department of the Army

Office of the Army, Deputy Chief of Staff for Logistics, Supply Policy, Washington, DC
Headquarters, Army Materiel Command, Washington, DC
Headquarters, Army Depot Systems Command, Chambersburg, PA
Armament, Munitions and Chemical Command, Rock Island, IL
Aviation Systems Command, St. Louis, MO
Missile Command, Huntsville, AL
Tank-Automotive Command, Warren, MI
Systems Integrated Management Activity, St. Louis, MO
Anniston Army Depot, Anniston, AL
Corpus Christi Army Depot, Corpus Christi, TX
Letterkenny Army Depot, Chambersburg, PA
Red River Army Depot, Texarkana, TX
Sacramento Army Depot, Sacramento, CA
Tooele Army Depot, Tooele, UT
Rock Island Arsenal, Rock Island, IL
Army Audit Agency, Washington, DC

Department of the Navy

Headquarters, Naval Air Systems Command, Washington, DC
Headquarters, Naval Sea Systems Command, Washington, DC
Headquarters, Naval Supply Systems Command, Washington, DC
Naval Aviation Supply Office, Philadelphia, PA
Ships Parts Control Center, Mechanicsburg, PA
Naval Sea Systems Command Detachment - Planning and Engineering for Repairs and Alterations (Carriers), Bremerton, WA
Naval Sea Systems Command Detachment - Planning and Engineering for Repairs and Alterations (Cruisers and Destroyers), Philadelphia, PA
Naval Sea Systems Command Detachment - Submarine Maintenance, Engineering, Planning and Procurement, Portsmouth, NH
Naval Ordnance Station, Louisville, KY
Naval Undersea Warfare Engineering Station, Keyport, WA

ACTIVITIES VISITED OR CONTACTED (continued)

Department of the Navy (cont'd)

Supervisor of Shipbuilding, Conversion, and Repair, Newport News, VA
Supervisor of Shipbuilding, Conversion, and Repair, San Francisco, CA
Trident Retrofit Facility, Kings Bay, GA
Naval Air Station, Mayport, FL
Naval Supply Center, Charleston, SC
Naval Supply Center, Jacksonville, FL
Naval Supply Center, Norfolk, VA
Naval Supply Center, Oakland, CA
Naval Supply Center, Pensacola, FL
Naval Supply Center, Puget Sound, WA
Naval Supply Center, San Diego, CA
Naval Aviation Depot, Alameda, CA
Naval Aviation Depot, Cherry Point, SC
Naval Aviation Depot, Jacksonville, FL
Naval Aviation Depot, Pensacola, FL
Naval Aviation Depot, North Island, CA
Naval Aviation Depot Operations Center, Patuxent River, MD
Naval Audit Service, Washington, DC
Naval Audit Service, Western Region, San Diego, CA

Department of the Air Force

Office of the Air Force, Deputy Chief of Staff for Logistics and Engineering, Supply Policy, Washington, DC
Headquarters, Air Force Logistics Command, Wright-Patterson AFB, OH
Headquarters, Air Training Command, Randolph AFB, TX
Oklahoma City Air Logistics Center, Tinker AFB, OK
Sacramento Air Logistics Center, McClellan AFB, CA
San Antonio Air Logistics Center, Kelly AFB, TX
Warner Robins Air Logistics Center, Robins AFB, GA
Air Force Maintenance and Regeneration Center, Davis Monthan AFB, AZ
12th Flying Training Wing, Randolph AFB, TX
Air Force Audit Agency, Norton AFB, CA

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Washington, DC
Defense Systems Automation Center, Columbus, OH
Defense Construction Supply Center, Columbus, OH
Defense Electronics Supply Center, Dayton, OH
Defense General Supply Center, Richmond, VA
Defense Industrial Supply Center, Philadelphia, PA

ACTIVITIES VISITED OR CONTACTED (continued)

Contractors

Lear Siegler Management Services Corporation, Randolph AFB, TX
Vitro Corporation, Rockville, MD

AUDIT TEAM MEMBERS

Donald E. Reed, Director, Logistics Support Directorate
James B. Helfrich, Program Director
Barbara M. Cobble, Project Manager
Debra E. Alford, Team Leader
Hewitt Q. McKinney, Team Leader
Luther N. Bragg, Team Leader
Richard L. Collier, Auditor
Victoria S. Dittrich, Auditor
Amy J. Frontz, Auditor
Frederick R. McComas, Auditor

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Assistant Secretary of the Navy (Financial Management)

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management and Comptroller)

Defense Agency

Director, Defense Logistics Agency

Non-DoD

Office of Management and Budget
U.S. General Accounting Office, NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Governmental Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations