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

REPORT
NO. 91-056 March 4, 1991

MEMORANDUM FOR COMPTROLLER OF THE DEPARTMENT OF DEFENSE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Final Quick-Reaction Report on Budgeting for War Reserve Stocks in the Defense Logistics Agency (Project No. 0LA-0077.01)

Introduction

We started the Audit of Budgeting for Secondary Supply Items in the Defense Logistics Agency (Project No. 0LA-0077) on July 16, 1990. The objective of the audit was to ascertain whether the Defense Logistics Agency (DLA) was adequately determining and accurately stating funding requirements for secondary items in its annual budget submission. War reserve requirements for secondary items are determined by the Services and consist of retail (pre-positioned) and wholesale (other war reserve) requirements. During the audit, we reviewed the policies and procedures related to the preparation of the FY 1992/FY 1993 Biennial Budget Estimates for the Defense Stock Fund that includes estimates for secondary items to meet peacetime operating requirements.

DLA improperly maintained protected levels of $1.26 billion of other war reserve stocks at five DLA supply centers (Centers) (Enclosure 1) and included those levels as mobilization requirements in developing its budget estimates for secondary items. As a result of this practice, a minimum of $520.0 million of the $1.26 billion was identifiable on a line item basis to peacetime deficiencies included in the Centers, March 31, 1990, stratification. This practice also included the maintenance of $541.0 million of other war reserve stocks that were not supported by war reserve requirements. To the extent applicable to current requirements, these stocks could be used to offset peacetime operating deficiencies included in the FY 1992/FY 1993 Biennial Budget Estimates for the Defense Stock Fund. It is our opinion that this practice of maintaining protected levels is improper because the DLA does not have fiscal authority to directly or indirectly fund other war reserve requirements with Defense Stock Fund monies.

Background

The DLA manages stocks applied to other war reserve requirements. The using Service manages stocks applicable to the

pre-positioned requirement and updates and submits its other war reserve requirements to DLA, annually, under provisions of DoD Instruction 4140.47, "Secondary Item War Reserve Requirements Development." As of the March 31, 1990, budget stratification, the five Centers had other war reserve requirements identified by the Services of about $7.1 billion. The DoD Budget Guidance Manual (DoD 7110-1-M) requires the DLA to base its budget for secondary items on a line item budget stratification prepared in accordance with DoD Instruction 4140.24, "Requirements Priority and Asset Application for Secondary Items." This instruction allows DoD Components to include other war reserve requirements in reorder point computations. Policy on the use and operation of the Defense Stock Fund is contained in DoD Regulation 7420.13-R, "Stock Fund Operations." This guidance provides that, "All inventories of supplies shall be financed by use of a stock fund, except for an item funded with a procurement appropriation." This guidance further provides, "Appropriations may be provided to stock funds for special requirements such as mobilization . . ." Congress has historically provided funding for secondary item war reserve (mobilization) requirements through direct appropriation.

Discussion

Other War Reserve Requirements. DLA was indirectly funding other war reserve requirements by improperly applying protected levels of stocks against these requirements. The protected levels of other war reserve stocks were accumulated through the "promotion" of assets stratified to a long supply (available assets exceeding requirements) position. Because these stocks were stratified to a protected level, they were not available to meet peacetime operating deficits and as a result, additional funds of up to $1.26 billion may be unnecessarily required. Significantly, the protected stocks were still maintained even when Service-based war reserve requirements for specific items no longer existed.

Promotion of Long Supply Assets. For the five Centers in our audit, $61.0 million of assets in a long supply position were promoted to protected levels of other war reserve stocks during the March 1990 stratification. These stocks were added to about $1.2 billion of protected stocks that were accumulated during prior stratification runs and included as other war reserve, protected requirements in the March 1990 stratification. The budget stratification identified line items that were in a long supply position each quarter. When a Service-generated other war reserve requirement existed for a line item stratified to long supply, the lesser of the Service-generated requirement or the long supply quantity was promoted to an other war reserve, protected level. For example, during the March 1990 stratification, the peacetime operating requirement for National Stock Number (NSN) 5935-00-897-3265, connector, was 1,053. There were 3,493 connectors on-hand. Thus, the connector was in a long

supply position by 2,440 items (3,493 on hand minus 1,053 requirements). There was a Service-based other war reserve requirement of 1,206 for the connector. Therefore, 1,206 of the 2,440 items in long supply were promoted to a protected level of other war reserve stock.

Additional Peacetime Operating Deficits. For the five Centers in the audit, we determined, on a line item basis, that peacetime operating deficits computed in the March 31, 1990, stratification could have been reduced by about $520.0 million over the 1 1/2 year FY 1990/FY 1991 stratification horizon through the use of available stocks that were inappropriately applied against the other war reserve, protected requirements. Additional on hand stocks of up to $740.0 million ($1.26 billion minus $520.0 million) would also be available to satisfy peacetime operating requirements in FY 1992 and later years. Available stocks were applied against other war reserve, protected requirements during the budget stratification run. Once applied, these stocks were no longer available for stratification against peacetime operating requirements. This resulted in additional peacetime operating deficits that required funding. For example, during the March 1990 stratification, total requirements for NSN 5961-00-724-2097, transistor, were for 3,588 items; 984 for other war reserve protected, and 2,604 for peacetime operating. There were 2,435 transistors on hand. Of the 2,435 items, 984 were applied against the other war reserve protected requirement, and the other 1,451 were applied against the peacetime operating requirements of 2,604 items. Thus, there was a deficit of 1,153 transistors for which funding was included in the stratification. However, the deficit would have been reduced to 169 transistors if the 984 transistors had not been inappropriately protected.

Unsupported Other War Reserve Stocks. For the five Centers, we determined that $541.0 million of the $1.26 billion of other war reserve stocks were not supported by valid requirements as of the March 31, 1990, budget stratification. This condition occurred because DLA did not provide for the elimination of other war reserve protected levels for specific items when the Service-generated war reserve requirements were eliminated. As discussed above for the transistor, the deficit of 1,153 items computed during the March 1990 stratification would have been reduced to 169 if the protected level of 984 items had been applied. This condition was further compounded because the Service-generated other war reserve requirement was only for 530 transistors. Thus, protected levels exceeded requirements by 454 items for this transistor.

Conclusion. The inclusion of stocks as a protected level in the budget stratification is an indirect means of funding other war reserve requirements. The DLA relied on policy contained in DoD Instruction 4140.24, dated September 10, 1969, as the basis

for promoting excess stocks to protected other war reserve stock levels. It is our opinion that the DLA does not have fiscal authority to indirectly fund other war reserve requirements. Stocks that are excess to current peacetime operating requirements should be retained when unfunded requirements for the stocks exist. However, such stocks should automatically revert to the original intended use when authorized requirements arise. Left unchecked, DLA's practices could result in the continual accumulation of other war reserve stock levels. Accordingly, DLA should discontinue the practice of protecting on hand stocks against other war reserve requirements and use such stocks to satisfy peacetime operating requirements. Conclusions reached at a July 1988 stratification improvement conference, chaired by the Director, Supply Management Policy, Office of the Assistant Secretary of Defense (Production and Logistics) [OASD (P&L)], support our position by concluding that " . . . Protectable War Reserve requirements will represent only that funding level approved by Congress and will not increase as the result of applying peacetime assets to the balance of war reserve requirements in previous stratifications."

Recommendations

1. We recommend that the Comptroller of the Department of Defense:

a. In coordination with the Assistant Secretary of Defense (Production and Logistics) issue budget guidance that requires the Defense Logistics Agency to recompute funding requirements for secondary items based on the application of on hand other war reserve protected stocks against peacetime operating requirements.

b. Reduce obligational authority for secondary items in the Defense Stock Fund by an appropriate amount for the on hand other war reserve protected stocks that could be used to satisfy authorized peacetime operating requirements. Other war reserve protected stocks totaled $1.26 billion based on the supply centers' budget submissions to Headquarters, Defense Logistics Agency. Of the $1.26 billion, about $520.0 million was specifically identified to deficiencies that should have been offset in the March 31, 1990, budget stratification.

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

a. Curtail ongoing procurement actions to reflect removal of other war reserve protected requirements that were included in reorder computations.

b. Take immediate action to adjust other war reserve materiel requirements levels that are used in budget

stratifications, as well as procurement computations, when the using service's most recent statements of requirements do not support those levels.

Management Comments

Comments from the Comptroller of the Department of Defense were due January 8, 1991. We had not received comments as of February 18, 1991.

The Deputy Comptroller, Defense Logistics Agency, responded to the draft report on January 14, 1991 (Enclosure 2).

The Deputy Comptroller, Defense Logistics Agency, disagreed with Recommendations 1.a. and 1.b. addressed to the Comptroller of the Department of Defense. Regarding Recommendation 1.a., to issue budget guidance requiring DLA to recompute funding requirements based on the application of on hand other war reserve materiel requirements protected (OWRMRP) stocks against peacetime requirements, she stated that there was no basis for the recommendation until DoD policy on reorder point computation is revised. Regarding Recommendation 1.b., to reduce obligational authority in the Defense Stock Fund by the amount of OWRMRP stocks that could be used to satisfy authorized peacetime requirements, she stated that the recommendation was not warranted because DoD has not issued obligational authority to DLA based on the stratification.

The Deputy Comptroller nonconcurred with Recommendation 2.a. (Recommendation 2. in the draft version of this report) to curtail ongoing procurement actions that included OWRMRP in reorder point computations. She stated that OWRMRP are a legitimate level in the DoD reorder point system.

The Deputy Comptroller also stated that the DLA was following current DoD policy contained in DoD Instruction 4140.24 that directs the Services and Defense agencies to include OWRMRP stocks in reorder point computations. Additionally, the Deputy Comptroller stated that no policy guidance was issued from the OASD (P&L) as a result of the July 1988 stratification conference.

Audit Response to Management Comments

DLA's comments on Recommendations 1.a. and 1.b. and the finding are not fully responsive to the issues addressed in the draft report. DLA has not taken responsive action to control its improper budget formulation procedures, pending a DoD revision in policy. We issued this report, in part, to address the conflicting guidance and the need for the Comptroller of the Department of Defense to issue revised guidance. We will more fully address the conflicting logistics and fiscal policies of the OASD (P&L) and Comptroller of the Department of Defense

respectively, as well as matters related to the actual accummulation and drawdown of OWRMRP stocks in our report on Project No. 0LA-0077. Regarding DLA's comments on Recommendation 1.b., the issuance of obligational authority based on the March 1990 stratification is more an execution than a budget formulation matter. Regardless of which budget stratification is used to issue obligational authority, we are requesting a reduction in the computed obligational authority because other war reserve stocks were improperly included in the budget formulation process.

DLA's comments are not responsive to Recommendation 2.a. DLA does not address the fiscal impropriety of including OWRMRP in the reorder point and, in effect, indirectly funding war reserve stocks with Defense Stock Fund monies. DLA bases the inclusion of OWRMRP in reorder point computations on logistics policy contained in DoD Instruction 4140.24, "Requirements Priority and Asset Application for Secondary Items," which was established in 1969. Later appropriations enacted by Congress have specifically provided for war reserves and overrides the logistics policy addressed by DLA. Fiscal policy contained in DoD Regulation 7420.13-R, "Stock Fund Operations," dated June 1986, addresses the use of appropriated funds for the financing of mobilization (war reserve) requirements. We believe that the conclusions addressed at the July 1988 stratification improvement conference indicated recognition of the need to bring logistics policy in line with fiscal policy. We believe that Recommendation 2.a. is still valid. Therefore, we request that the Director, Defense Logistics Agency, reconsider his position and provide comments on this final report.

In response to DLA's comments to Recommendation 2.a., we have included Recommendation 2.b. A similar recommendation was originally made in Audit Report No. 88-092, "Secondary Item War Reserves," dated March 1, 1988. In that report, DLA concurred with our recommendation to change the Standard Automated Materiel System to automatically adjust war reserve stock levels when requirements for the items are reduced. DLA provided a target date of December 31, 1992 for the change. Notwithstanding efforts to execute a drawdown of inapplicable other war reserve requirements, these drawdown actions occur only on individual line items when the reorder point is actually breached. Requirements for these items, as well as line items for which the reorder point is not breached are still included in DLA's budget and result in overstated funding requests. Moreover, the manual process to drawdown the inapplicable other war reserves was not fully implemented and will be discussed in our report on Project No. 0LA-0077. We believe that immediate action should be taken to correct this matter. We ask that the Director, Defense Logistics Agency, provide a concurrence or nonconcurrence with Recommendation 2.b. in response to this final report.

We request that the Comptroller of the Department of Defense provide comments in accordance with DoD Directive 7650.3 on Recommendations 1.a. and 1.b. in response to the final report. If you concur, describe corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, state your specific reason for each nonconcurrence.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Accordingly, final comments on unresolved issues in this report must be provided within 15 days of the date of the final report. We also request that the Comptroller of the Department of Defense provide a concurrence or nonconcurrence with the $1.26 billion of monetary benefits identified in Enclosure 3 of this report.

The courtesies and cooperation extended to the audit staff are appreciated. If you have any questions about this final report, please contact Mr. James Koloshey at (703) 614-6225 (AUTOVON 224-6225) or Mr. Stuart Dunnett at (703) 614-6222 (AUTOVON 224-6222). A list of the audit team members is in Enclosure 4. Final report distribution is shown in Enclosure 5.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc: Assistant Secretary of Defense (Production and Logistics)

SUMMARY OF DEFENSE LOGISTICS AGENCY'S OTHER
WAR RESERVE REQUIREMENTS AND PROTECTED STOCK LEVELS
AS OF MARCH 31, 1990
($MILLIONS)

Activity	Other War Reserve Requirements	Other War Reserve Protected Levels
Defense Construction Supply Center	$ 286.3	$ 127.7
Defense Electronics Supply Center	238.1	187.3
Defense General Supply Center	522.6	111.6
Defense Industrial Supply Center	148.6	91.0
Defense Personnel Support Center (Medical)	1,923.8	89.6
(Clothing and Textile)	3,967.8	657.3
TOTAL	$7,087.2	$1,264.5

ENCLOSURE 1

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

IN REPLY REFER TO DLA-CI

14 JAN 1991

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Draft Quick-Reaction Report on Budgeting for War Reserve Stocks in the Defense Logistics Agency (Project No. 0LA-0077.01)

The enclosed comments to the draft quick-reaction report are approved and provided in response to your memorandum dated 19 December 1990.

Encl

HELEN T. McCOY
Deputy Comptroller
Defense Logistics Agency

TYPE OF REPORT: AUDIT DATE OF POSITION: 14 Jan 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Quick-Reaction Report on Budgeting for War Reserve Stocks in the Defense Logistics Agency (Project No. OLA-0077.01)

FINDING: DLA improperly maintained protected levels of $1.26 billion of other war reserve stocks at five DLA supply centers (Centers) (Enclosure 1) and included those levels as mobilization requirements in developing its budget estimates for secondary items. As a result of this practice, a minimum of $520.0 million of the $1.26 billion was identifiable on a line item basis to peacetime deficiencies included in the Centers, March 31, 1990, stratification. This practice also included the maintenance of $541.0 million of other war reserve stocks that were not supported by war reserve requirements. To the extent applicable to current requirements, these stocks could be used to offset peacetime operating deficiencies included in the FY 1991/FY 1993 Biennial Budget Estimates for the Defense Stock Fund. It is our opinion that this practice of maintaining protected levels is improper because the DLA does not have fiscal authority to directly or indirectly fund other war reserve requirements with Defense Stock Fund monies.

DLA COMMENTS: NONCONCUR. DLA actions to maintain Other War Reserve Materiel Requirement, Protectable (OWRMRP) conforms to current DoD policy. It is a legitimate level in the DoD reorder point system. DODI 4140.24 tells the Military Services and Agencies to include the OWRMRP in the reorder point. It is confusing and contradictory that this Agency would be asked to comply with the instruction in one regard and to discontinue compliance in another. Perhaps this matter should be addressed as a DoD policy issue.

The report implies that all protectable war reserve stocks are obtained through the application of long supply. This is not the case. These stocks are also obtained when items are transferred from the Services to DLA for management and a war reserve protectable level exists, as well as from field returns. Promotion of stocks to protectable war reserve in no way adversely affects peacetime support. These stocks are not protected from issue to meet peacetime demand, if required, but are replenished from the next due in. Additionally, promotion of long supply assets only occurs when assets exceed the Approved Force Acquisition Objective (AFAO) which includes not only peacetime requirements but several authorized retention levels.

Long supply assets are never promoted to protectable in the absence of an Other War Reserve (OWR) requirement from the Military Services. Inapplicable protectable occurs only after the Service submitted OWR requirement is subsequently reduced. The inapplicable is drawn down when the reorder point is breached. No mention of this drawdown process was made in the report. Inapplicable is not drawn down when there is no reorder point breach or no peacetime demand. If it were, it would simply stratify to excess. If there is no peacetime demand for inapplicable assets, there is no opportunity to use these assets to offset peacetime materiel deficiencies.

Regarding the July 88 stratification improvement conference, no policy guidance was issued from OASD (P&L) as cited in the finding. Nor was the conclusion stated in the draft report obvious to other attendees.

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

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(X) Nonconcur. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Sherry Barker, DLA-CR, 47826

DLA APPROVAL: Helen T. McCoy

TYPE OF REPORT: AUDIT DATE OF POSITION: 14 Jan 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Quick-Reaction Report on Budgeting for War Reserve Stocks in the Defense Logistics Agency (Project No. OLA-0077.01)

RECOMMENDATION 1: We recommend that the Comptroller of the Department of Defense:

(a) In coordination with the Assistant Secretary of Defense (Production and Logistics) issue budget guidance that requires the Defense Logistics Agency to recompute funding requirements for secondary items based on the application of on hand other war reserve protected stocks against peacetime operating requirements.

(b) Reduce obligational authority for secondary items in the Defense Stock Fund by an appropriate amount for the on hand other war reserve protected stocks that could be used to satisfy authorized peacetime operating requirements. Other war reserve protected stocks totalled $1.26 billion based on the supply centers budget submissions to Headquarters Defense Logistics Agency. Of the $1.26 billion, about $520.0 million was specifically identified to deficiencies that should have been offset in the March 31, 1990, budget stratification.

DLA COMMENTS: NONCONCUR. Until such time as DoD policy is revised relative to reorder point computation, there is no basis for recommendation 1.a. Further, since DoD has not issued obligational authority to DLA based on the stratification, recommendation 1.b. is unwarranted.

DISPOSITION:
( ) Action is ongoing; Final Estimated Completion Date:
(X) Action is considered complete (pending results of physical verification).

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

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(X) Nonconcur. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Sherry A. Barker, DLA-CR, 47826

DLA APPROVAL: Helen T. McCoy

TYPE OF REPORT: AUDIT DATE OF POSITION: 14 Jan 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO.: Draft Quick-Reaction Report on Budgeting for War Reserve Stocks in the Defense Logistics Agency (Project No. OLA-0077.01)

RECOMMENDATION 2: We recommend that the Director, Defense Logistics Agency, curtail ongoing procurement actions to reflect removal of other war reserve protected requirements that were included in reorder computations.

DLA COMMENTS: NONCONCUR. The OWRMRP is a legitimate level in the DoD reorder point system.

DISPOSITION:
( ) Action is ongoing; Final Estimated Completion Date:
(X) Action is considered complete (pending results of physical verification).

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

INTERNAL MANAGEMENT CONTROL WEAKNESS:
(X) Nonconcur. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be reflected in the DLA Comments and documentation must be maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Sherry A. Barker, DLA-CR, 47826

DLA APPROVAL: Helen T. McCoy

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1a. and b.	Avoid unnecessary or premature funding of wholesale inventory by five Defense Logistics Agency (DLA) supply centers.	Questioned costs. A one-time reduction in obligational authority of up to $1.26 billion to the Defense Stock Fund based on the March 31, 1990, budget stratification. The $1.26 billion represents stocks that could be used to satisfy peacetime operating deficiencies being funded in the FY 1992/FY 1993 Biennial Budget. Further analysis of HQ DLA and DoD Comptroller actions on the supply centers budget submissions is necessary before specific amounts and the timing of cuts in obligational authority can be identified.
2.	Avoid unnecessary or premature purchase of wholesale inventory by five DLA supply centers.	Cost Avoidance. A one-time cost avoidance that would avoid unnecessary or premature purchases of wholesale inventory relating to ongoing procurement actions that would be reduced or canceled by the application of on hand other war reserve protected stocks. Amounts can only be determined after review of ongoing procurement actions.

AUDIT TEAM MEMBERS

Shelton R. Young, Director, Logistics Support Directorate
Gordon P. Nielsen, Deputy Director
James L. Koloshey, Program Director
Stuart D. Dunnett, Project Manager
Luther N. Bragg, Team Leader
John M. Gregor, Team Leader
Benedicto M. Dichoso, Auditor
Marcia L. Kilby, Auditor