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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

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DEFENSE DIVISION

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Dear Mr. Secretary:

The General Accounting Office has performed a limited follow-up examination into the effectiveness and economy of the Air Force's physical inventory program for supplies and equipment stocked at Air Force air materiel areas. Our field work, which was completed in July 1971, was performed at the Oklahoma City, Sacramento, and San Antonio Air Materiel Areas; and the Air Force Logistics Command.

In a prior report to the Congress entitled, "Improved Inventory Controls Needed for the Departments of the Army, Navy, Air Force, and the Defense Supply Agency" (B-146828, dated November 14, 1967), we reported that inventory records throughout the Department of Defense were generally unreliable. We pointed out that the failure of supply personnel to properly research and reconcile physical inventory differences and to make required adjustments to stock records were major recurring causes of inventory record errors. In May 1968, the Air Force Auditor General's office reported that physical inventories taken at the Air Force's five air materiel areas did not improve the validity of inventory records because of faulty physical inventory reconciliation and adjustment practices.

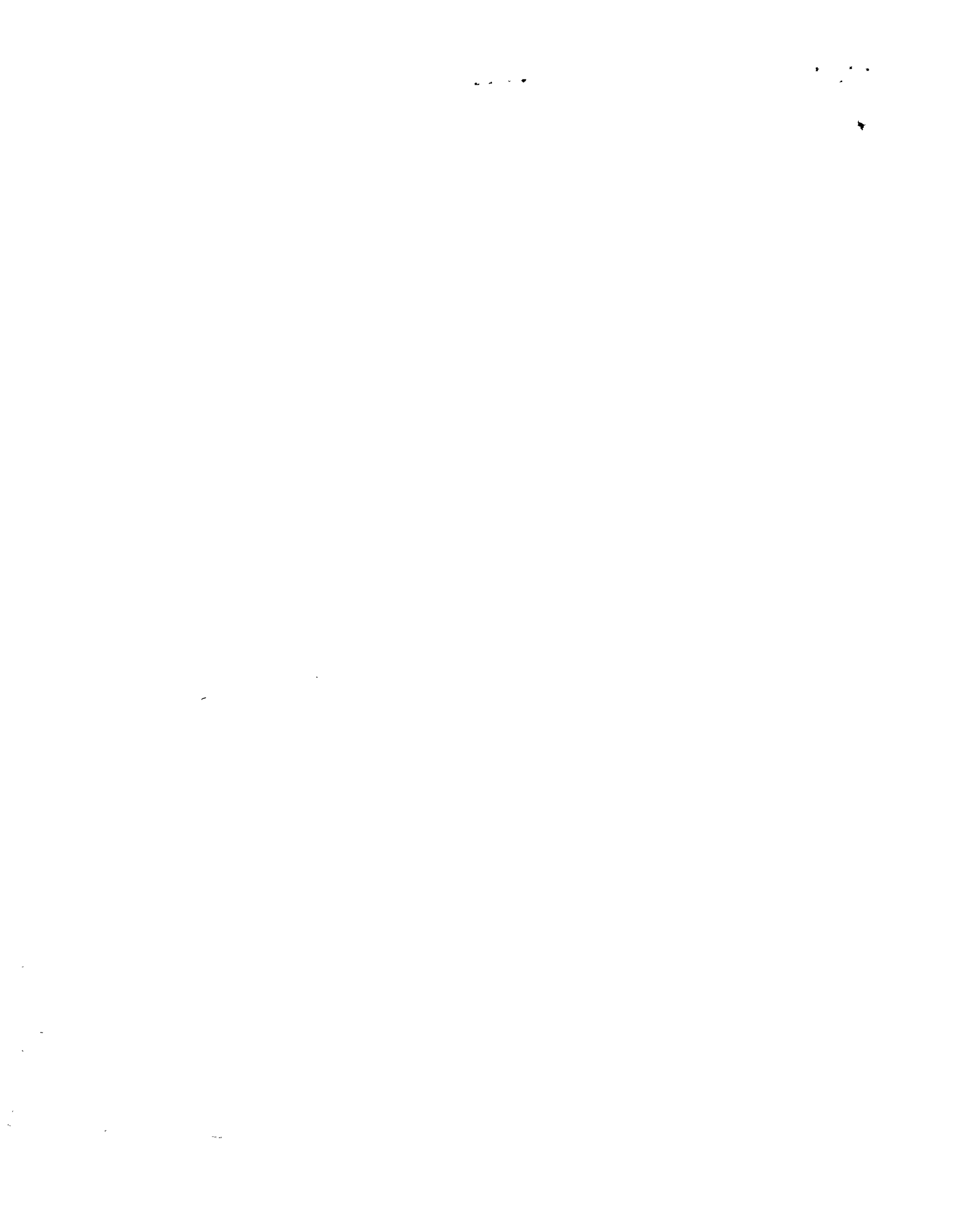
Our follow-up review disclosed that the problems previously cited still exist. Inventory record inaccuracies are frequently not corrected by physical inventories because of the repeated failure of supply personnel to accurately count stock and to make required adjustments to inventory records. Details of our findings follow.

PHYSICAL INVENTORIES OF ACTIVE INVESTMENT ITEMS

Air materiel areas are required to physically inventory all active investment items (high-dollar value items or reparable items with a large stock turnover) on a regularly scheduled quarterly basis. During the quarter ending September 30, 1970, the three air materiel areas included in our review physically inventoried 4,598 items of this nature.

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Based on our analysis of a randomly selected statistical sample, we estimate that 3,219 of the items required inventory record adjustment. We found that 49 percent of the required adjustments were either not made or were made incorrectly due to inaccurate physical counts or erroneous reconciliation of major stock differences. The inaccurate counts and erroneous reconciliations occurred because warehousemen and inventory managers did not comply with prescribed procedures. Warehousemen did not identify stock received and issued during the physical inventory cycle for items being inventoried. Inventory managers frequently made incorrect assumptions as to the causes of major stock differences in order to reconcile the differences and avoid major physical inventory adjustments. These conditions are illustrated below.

On August 7, 1970, an inventory record cut-off balance of 606 units of FSN 4220-K1400-510ALS was established for physical inventory comparison purposes at the San Antonio Air Materiel Area. On August 14, 1970, a physical count showed 1,148 units on hand. As a result, the inventory record balance for this item was increased by 542 units. Our research showed that 522 units were issued after the inventory cut-off date and prior to the count date. Therefore, the 522 units should have been added to the count quantity. Also, 1,148 units received after the cut-off date were included in the physical count and should, therefore, have been deducted from the count quantity. Thus, the adjusted count quantity should have been 522 units, and the inventory record balance should have been decreased by 84 units rather than increased by 542 units.

In July 1970, a physical inventory of FSN 2840-953-8283RV at the Oklahoma City Air Materiel Area revealed a stock shortage of 418 units valued at \$64,372. The inventory manager's research of this shortage disclosed that the inventory record balance for this item was decreased by 1,134 units and subsequently increased by 403 units on the same day in October 1969 as a result of a stock issue and stock denial, respectively. The inventory manager assumed that the stock denial of 403 units was erroneous and that 1,134 units were actually issued. As a result a shortage of 403 units was considered reconciled and a physical inventory loss adjustment of 15 units valued at \$2,310 was made to the inventory record. Our research of shipment records showed that the inventory manager's assumption was incorrect. We found that only 731 units were actually

issued because the remaining quantity of 403 units could not be located in the warehouse. Therefore, we believe that a physical inventory loss adjustment of 418 units valued at \$64,372 should have been made.

On the basis of our tests, we estimate that the inventory records for 1,563 items, or 34 percent of the items inventoried, still contained stock shortages and overages, valued at about \$8.8 million, subsequent to physical inventory and inventory record adjustment actions.

WALL-TO-WALL PHYSICAL INVENTORIES

This type of physical inventory involves a complete count of classified and pilferable type items and other items comprising designated Federal supply classes. Wall-to-wall physical inventories accounted for 81 percent of all regularly scheduled physical inventories taken in fiscal year 1970.

We made a limited evaluation of a wall-to-wall physical inventory taken in May 1970 at the San Antonio Air Materiel Area. This physical inventory involved a count of 19,257 items (radio and television communication equipment, sound recording equipment, etc.) with recorded stock valued at \$225 million.

Our tests showed that required inventory record adjustments were not made or were made incorrectly for 16 of 20 randomly selected items due to inaccurate counts (similar to example on page 2) and erroneous reconciliations. For example, a physical count of one item disclosed a shortage of 129 units valued at \$72,756. The inventory record for this item was not adjusted because a recount supposedly reconciled or eliminated the shortage disclosed by the first count. However, we found that the recount revealed a shortage of 190 units valued at \$107,160.

STATISTICAL SAMPLING PHYSICAL INVENTORIES

With the exception of those item classifications mentioned in the above paragraphs, air materiel areas are required to evaluate the inventory record accuracy for all stocked items on a statistical sampling basis over a 2-year cycle.

For statistical sampling purposes, items are grouped into designated inventory lots. A physical count is made of a representative sample of items, normally 75, selected from each lot.



If no more than four of the sample items are found to have major errors (recorded stock locations but no recorded stock quantities, or vice versa; and stock differences valued at \$200 or over), all items in the lot are considered to have acceptable inventory record accuracy and no further action is required. If more than four items have major errors, a physical count is made for either a larger sample of items or for all items in the lot.

In fiscal year 1970, the three air materiel areas reviewed by us statistically evaluated the overall inventory record accuracy for 30 lots, consisting of about 411,000 items. The statistical sampling results reported to higher management levels indicated that all 30 lots had acceptable inventory record accuracy. However, our limited tests indicate that the reported statistical sampling accuracy results were of questionable validity.

At the Sacramento and San Antonio Air Materiel Areas, we found that the sample selection process was biased by the exclusion of items with recorded stock locations but no recorded stock quantities. Also at the San Antonio Air Materiel Area, we found that documents evidencing recent stock receipts were falsely prepared for the purpose of reconciling major inventory overages for sample items. This was done to permit the reporting of acceptable sample inventory accuracy for the effected lot of items, thus avoiding the possible necessity of having to take a physical count of all items in the lot (approximately 11,000 items).

ADVERSE EFFECTS OF FACILITY
PHYSICAL INVENTORY PRACTICES

In addition to performing hundreds of thousands of regularly scheduled physical inventories annually to maintain accurate inventory records for all stocked items, air materiel areas have also taken about 516,000 special or unscheduled physical inventories yearly at an estimated annual cost of \$2.6 million. These special inventories were taken as emergency measures to resolve inventory errors not previously corrected by regular physical inventories.

We believe that a substantial number of these special inventories were necessitated by inventory errors which were either caused by or should have been corrected by prior physical inventories. In this respect, we found a number of instances in which



items were repeatedly subjected over a short timespan to a mixture of scheduled and special physical inventories. These inventories were taken to correct errors, some of which were caused by the physical inventories themselves. For example, one item was inventoried 26 times (mixture of regular and special) in fiscal year 1970. Some of these inventories were taken only a few days apart and resulted in offsetting gain and loss adjustments, indicating that the original adjustments were made in error.

CONCLUSIONS AND RECOMMENDATIONS


The occurrence of inaccurate physical counts, erroneous reconciliation of major inventory differences, and invalid physical inventory adjustments were sufficiently frequent, in our opinion, to impair the effectiveness and economy of the Air Force's physical inventory program. We believe our findings show that prescribed physical inventory procedures are not well understood or followed by warehousemen and inventory managers. Also, existing physical inventory controls do not ensure compliance with prescribed procedures.

We believe that improvements in physical inventory controls will result in a significant increase in inventory record accuracy and a substantial reduction in the physical inventory workload. We are, therefore, recommending that supply personnel be provided with more frequent and comprehensive instruction on physical inventory procedures and techniques. Also, we recommend that more rigid controls be instituted to enforce compliance with prescribed procedures. Finally, we recommend that increased internal audit coverage be given to this area.

These recommendations are subject to the provisions of Section 236 of the Legislative Reorganization Act of 1970. We will appreciate receiving copies of the statements you furnish the specified committees in accordance with these provisions. If you desire, we will be glad to discuss these matters in greater detail with you or your staff.

Copies of this letter are being sent to the Secretary of Defense.

Sincerely yours,


Director

The Honorable
The Secretary of the Air Force

