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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

PROCUREMENT, LOGISTICS, AND READINESS DIVISION

B-210360

FEBRUARY 7, 1983

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The Honorable Verne Orr
The Secretary of the Air Force

Dear Mr. Secretary:

Subject: Continued Improvements Needed in Air Force Procedures and Practices for Identifying and Canceling Excess On-order Stocks (GAO/PLRD-83-36)

We have completed a followup review of the effectiveness of actions taken by the Air Force to improve its procedures and practices for identifying and canceling excess on-order stocks of system support stock fund items (aircraft subassemblies, repair parts, and consumables). Our review identified continuing problems which inhibit the identification and potential cancellation of excess on-order stocks valued at tens of millions of dollars annually.

In response to an earlier report 1/ on this subject, the Air Force made a policy change which increased the potential for canceling excess on-order stocks by $39 million or more. Our follow-up review shows that the Air Force can further increase its potential for cancellation of such stocks by $58 million or more. This can be done by doing more to correct weaknesses which we previously identified and which still exist.

In computing requirements and termination levels for on-order stocks, the Air Force is still using excessive buffers of stock above item requirements, which precludes timely identification and cancellation of on-order stocks which exceed requirements. Also, the Air Force still does not have an effective system to monitor the performance of air logistics centers in canceling excess on-order stocks.

1/"DOD Can Save Millions of Dollars by Improving the Management of Air Force Inventories" (LCD-80-6, Oct. 25, 1979).

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BACKGROUND

A computerized system at the air logistics centers computes requirements objectives for all system support stock fund items. This system is run four times per month. One of its functions is to give item managers notices identifying on-order stocks which exceed an item's termination level. After the initial notice, repeat notices are produced quarterly as long as the items have on-order stocks in a terminable status.

The requirement objective for system support stock fund items consists of an economic order quantity (EOQ) representing a 6-month to a 3-year supply--depending on the item's annual demand, plus stocks sufficient to satisfy procurement leadtime, safety level, backorder, programed depot maintenance, and war reserve requirements. The termination level consists of the sum of the requirement objective, a 6- or 12-month stock buffer (6 months for items with annual dollar demands of more than $500 and 12 months for $500 or less), plus unfunded war reserve requirements.

Upon receiving termination notices, item managers are supposed to determine the amount of on-order stocks above requirement objectives which either have been contracted for or are still in a purchase request status. Those still in a purchase request status are supposed to be promptly canceled. If the excess on-order stocks are on contract, termination action is supposed to be initiated if such stocks are valued at $2,500 or more.

Decisions on whether to finalize contract termination actions are supposed to be based on such factors as anticipated termination costs based on the amount of expired production leadtime, increasing or decreasing item usage, and repurchase cost versus inventory holding cost. Decisions not to terminate are supposed to be fully documented.

In our 1979 report to the Secretary of Defense, we pointed out that the Air Force could save millions annually in procurement costs by improving its policies, procedures, and practices for identifying and canceling on-order stocks exceeding requirements. We recommended that the Air Force (1) place greater emphasis on the canceling of excess on-order stocks, (2) eliminate the use of additional levels of stock above item requirement objectives as a buffer in establishing termination levels for on-order stocks, (3) issue repeat termination notices more often, and (4) establish a reporting system which would enable higher management levels to monitor and evaluate the performance of air logistics centers in canceling on-order stock excesses.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of this followup review were to (1) assess the effectiveness of corrective actions taken by the Air Force in response to our prior report and (2) determine whether significant additional improvements were needed.

We reviewed current policies and procedures for computing requirements and termination levels for system support stock fund items and for identifying and canceling excess on-order stocks. Also, we evaluated the implementing procedures, automated programs, and practices at two of the five air logistics centers.

We obtained the tapes used by the five centers to compute requirements and stratify assets for system support stock fund items for the quarterly cycle ended December 31, 1981. We used our computer data retrieval system to make a 100 percent computerized analysis of data shown on the Air Force tapes to determine the universe of items with assets above termination levels and the related dollar value of on-order stocks exceeding requirements which were (1) on contract and (2) on purchase requests. We also analyzed the Air Force study, completed in July 1980, which compared the cost effectiveness of its termination policies with those of the Defense Logistics Agency and the Army.

Our review was conducted from February through October 1982 at the Oklahoma City, Oklahoma, and San Antonio, Texas, Air Logistics Centers. We also visited the Air Force Logistics Command, Wright-Patterson Air Force Base, Ohio, to obtain clarification of policy matters and to obtain the views of command officials on our observations. Also, we visited the Defense Logistics Agency (DLA) and the Army Materiel Development and Readiness Command to become familiar with their policies and procedures for computing EOQ requirements for stock fund items and for identifying and canceling excess on-order stocks. Our review was conducted in accordance with generally accepted government audit standards.

CONTINUED IMPROVEMENTS NEEDED IN CANCELING EXCESS ON-ORDER STOCKS

In response to our 1979 report, the Air Force agreed that there was no historical basis for its use of additional levels of stock above requirements as a buffer in computing termination levels for on-order stocks. However, it declined to eliminate these buffers on the basis that its July 1980 study showed that its termination policy compared favorably with those of other agencies.

As an alternative, the Air Force stated that its policy had been changed to provide that on-order stocks exceeding item termination levels be cut back to item requirement objectives, rather than termination levels as was previously done. However, this change did not provide for identifying and canceling on-order stocks exceeding item requirements unless the quantity exceeded the termination level. For example, if an item had a requirement objective of 50 units, a termination level of 68 (18-unit buffer based on 6 months of supply at a monthly demand of 3 units), no assets on hand, and 60 on order, the 10 units on order exceeding requirements would not be identified for cancelation action because the termination level would not have been breached. However, had 70 units been on order, thus exceeding the termination level, cancellation action would be required for the 20 units exceeding requirements.

In response to our 1979 report, the Air Force also disagreed with the necessity of improving visibility over the performance of air logistics centers in controlling on-order stock excesses. However, the Air Force directed the centers to place maximum emphasis on prompt cancellation of excess on-order stocks. The Air Force also changed its policy to provide for issuance of repeat on-order termination notices monthly, rather than quarterly.

The Air Force further advised us that the standard automated system used by its logistics centers could not be revised to implement these changes until completion of a planned changeover to update computer hardware. Our followup review showed that automation of these changes will be done by June 1983. In the interim, the centers were directed in August 1980 to have item managers, upon receiving termination notices, manually recompute terminable on-order quantities based on a cutback to item requirement objectives.

By providing for cutting back to requirement objectives, rather than termination levels, the Air Force increased its potential for canceling excess on-order stocks by $39 million or more. Our analysis of quarterly requirement data for the logistics centers at Oklahoma City and San Antonio showed that 4,847 of the items they managed had on-order stocks valued at $92.8 million which exceeded termination levels. A cutback of on-order stocks for these items to requirement objectives would increase on-order stocks subject to cancellation by $39.4 million to $132.2 million.

Although the Air Force changes are a step in the right direction, additional improvements are needed. Our followup review showed that the Air Force could realize additional savings of $58 million or more by (1) reducing on-order termination level stock buffers which are unreasonably high and eliminating those that are not justified and (2) establishing a system for monitoring and evaluating the performance of logistics centers in controlling on-order stock excesses.

Need for a reduction in some on-order termination level stock buffers and elimination of others

Our analysis of the July 1980 study on which the Air Force based its decision to retain the additional levels of stock above requirement objectives as a buffer in establishing termination levels for on-order stocks revealed a number or shortcomings which distorted the results. The study did not consider the fact that the Air Force uses a 6-month minimum buy constraint in computing EOQ requirements, whereas the other agencies studied use the 3-month minimum constraint recommended by the Department of Defense (DOD). Also, the study did not consider the 12-month stock buffer used in establishing on-order termination levels for items with low annual dollar demands ($500 and under). Further, the study report did not highlight the study results which showed that a 3-month buffer provided the same protection against uneconomical on-order terminations as a 6-month buffer for items with annual dollar demands above $500.

The Air Force could reduce its 6-month stock buffer by 3 months without affecting readiness and could eliminate its 12-month buffer without compromising supply effectiveness. With respect to the latter, more than adequate protection against uneconomical terminations and stockouts is provided by a 3-year EOQ buy and a $2,500 threshold for contract termination, which alone provided a supply equivalent to 5 years' demand.

Our computerized retrieval and simulation of data used by the Oklahoma City and San Antonio Logistics Centers to compute system support requirements and on-order termination levels for a quarterly stratification cycle showed that a 3-month reduction in the 6-month buffer and elimination of the 12-month buffer would have increased the amount of on-order stocks subject to cancellation at the two centers from $132.2 million to $190.5 million. Thus, at only two of the five centers, the reduced and eliminated buffers would have increased potential cancellation of excess on-order stocks by $58.3 million. Also, $33.6 million of this increased potential for cancellation represented on-order stocks on purchase requests which could be canceled at minimal costs.

In addition, the Air Force could further increase its dollar potential for canceling excess on-order stocks by excluding unfunded war reserve requirements from computation of termination levels for on-order stocks. On-order stocks protected by termination levels are not normally used to fill or reduce unfunded war reserve requirements. Only available assets that are in long supply--those that exceed peacetime requirements by 2 or more years--are used to fill war reserve requirements. As noted earlier, some excess on-order stocks may already be on contract and it may not be economical to terminate. Such items, when received, could result in the items being in long supply. Rather than dispose of them, long supply items should logically be used to fill unfunded war reserve requirements. In our opinion, however, there is no justifiable basis for the routine use of these unfunded requirements as a buffer in establishing on-order termination levels. The on-order termination levels of the five centers included $28.5 million of unfunded war reserve requirements.

In May 1982, we advised Logistics Command officials of our observations on the Air Force's on-order termination stock level buffers. The command analyst responsible for the 1980 study confirmed the shortcomings in the study as we had revealed. Also, command data system and system support officials agreed that on-order stocks protected by termination levels should not be used to fill or to reduce unfunded war reserve requirements. Therefore, they agreed that there was no justifiable basis for their routine use in establishing on-order termination levels.

Need for a system for monitoring the performance of logistics centers in canceling on-order excesses

Our 1979 report noted that only a limited amount of on-order stock excesses at the logistics centers were being canceled (less than 6 percent at one of the audited centers) because of untimely and ineffective actions by item managers. Higher management levels, responsible for approving the release of procurement funds and for monitoring supply performance, did not have visibility over centers' performance in controlling on-order stock excesses.

Our followup review disclosed a continuing need for improvements in item managers' performance in canceling excess on-order stocks and for an effective system to monitor that performance. For the quarter ended December 31, 1981, the five centers reported to the Logistics Command that they had on-order stocks valued at $146.4 million which exceeded termination levels. The reports did not show the extent to which the on-order stock excesses were potentially cancelable or were being canceled.

Of the reported on-order excesses, $39 million, or 26.7 percent, were still in a purchase request status and therefore could have been canceled at minimal costs. At the Oklahoma City Center, item managers canceled less than 5 percent of the dollar value of on-order stock excesses identified for the week ended December 31, 1981. Similarly, at the San Antonio Center, item managers canceled less than 6 percent of the value of on-order stock excesses identified for the week ended March 31, 1982.

Maximum reductions in excess on-order stocks were not being achieved at these two centers because item managers often (1) did not reduce excess on-order stocks exceeding termination levels to item requirement objectives, (2) erroneously applied the dollar threshold criterion for contract terminations to on-order excesses that were still in a purchase request status, and (3) made routine certifications that it was uneconomical to cancel contracted quantities of on-order excesses because of continuing need without a detailed analysis of supply status, usage trends, and holding versus termination costs. Examples of these conditions are presented below.

--In response to a June 30, 1982, termination notice, an item manager at San Antonio canceled 16 on-order units of an adapter (stock no. 5120-01-060-1483 PT) valued at $840.16. As of June 30, 1982, 127 units of this item were on hand and on order. The 58 units on order were all in a purchase request status. The item's requirement objective was 99 units and its termination level was 111 units (99 units plus a 6-month buffer of 12 units based on monthly demands of 2 units). The item manager should also have canceled the additional 12 on-order units valued at $630.12 which exceeded the item's requirement objective. He stated that he was not familiar with the Air Force's policy change which requires cutting back on-order stocks exceeding termination levels to item requirement objectives.

--An item manager at San Antonio took no action in response to a March 31, 1982, termination notice for 50 units of an F-5E aircraft engine part (stock no. 2840-01-089-9936 RX) due in from a contract, even though the 985 units on hand exceeded the stock retention level and represented a 15.7-year supply. The item manager noted on the termination notice that no action was being taken because of a continuing requirement to fill a requisition from a foreign country which specified that only delivery of a General Electric product in new or unused condition would be acceptable. We found that all 985 units on-hand, including 627 recently delivered, had been produced by General Electric and were in new or unused condition. After we pointed this out to Center officials, they took action to terminate the contract for the 50 F-5E aircraft engine parts valued at $52,124.50.

The routine certification by item managers that it is uneconomical to cancel excess on-order stocks because of possible future needs is a continuing problem. To determine its long-term impact we examined the current inventory posture of 40 sample items which had excess on-order stocks at the time of our earlier review and which had not been canceled because of a stated continuing need. At the time of our earlier review, the on-hand and on-order quantities of many of these items represented several years' supply based on declining usage trends.

As of July 1982, 11 of the items sampled had stocks on-hand in excess of retention levels (7 plus years) which could have been minimized by prior cancellations of excess on-order stocks. The years of supply currently on hand for these items range from 12 or more years for items for which there is still some usage to infinity for items related to aircraft that have been phased out.

For example, in October 1978 an item manager at the Oklahoma City Logistics Center received a termination notice for 42,000 units of a B52D aircraft engine part (stock no. 2840-00-645-2327 RU) valued at $6,720 which had been ordered by mistake due to a computer problem. The mistake was discovered and a termination notice issued 31 days after the contract award. But the item manager did not try to terminate the contract on the basis that it would be uneconomical because of a continuing need. At that time, the quantity on hand and on order for this item represented a 9-year supply. No subsequent buys of this item have been made since our last review, and the aircraft on which this part is used is being phased out. As of July 1982, the Center had a 14.8-year supply on hand (125,353 assets on hand with projected annual usage of 8,455 assets). The retention level for this item is 81,677 units. Thus, the 43,676 units on hand in excess of retention slightly exceed the 42,000 excess on-order units not canceled in 1978.

After we discussed the above problems with Center officials, they issued directives to item managers reemphasizing compliance with Air Force regulations. Later, we found that at the Oklahoma City Air Logistics Center, the dollar rate of excess on-order cancellations increased to 14.2 percent for on-order stock excesses identified for the week ended March 31, 1982. Similarly, at the San Antonio Center, the dollar rate of cancellations increased to 32.9 percent for on-order excesses identified for the week ended September 30, 1982.

Maximum reductions in on-order excesses needed to alleviate funding shortfalls

Improvements in Air Force procedures and practices for maximum reduction of on-order stock excesses are especially appropriate now because of current and anticipated shortfalls in the Air Force's fiscal years 1982 and 1983 stock fund obligational authority. The Air Force Logistics Command informed its air logistics centers of these shortfalls in March 1982 and advised them to take measures to prevent overobligation of funds and to minimize impact on force readiness.

The Oklahoma City and San Antonio Centers experienced fiscal year 1982 shortfalls totaling $199 million. In contrast, these centers, at the time of review, had on-order stocks above termination levels that exceeded requirements by $132.2 million.

In May 1982, we asked Logistics Command officials why they had not emphasized to the logistics centers maximum reduction of excess on-order stocks as a means of alleviating shortfalls in funding in view of the large amounts of excess on-order stocks periodically reported by the centers. They said they were not aware that the air logistics centers were not making maximum reduction of excess on-order stocks. They stated that their only visibility over performance of the centers in reducing excess on-order stocks was as part of an annual stock fund management review. During this review, they evaluate actions taken by item managers on 10 on-order termination notices at each center.

After our discussion, command officials, by letter dated May 27, 1982, emphasized to the centers maximum reduction in excess on-order stocks as a means of alleviating the current stock fund shortage. Additionally, the centers were asked to provide on-order termination data for 1981 which would enable the command to assess their performance in canceling excess on-order stocks. The data requested included the number of (1) termination notices for on-order stocks on purchase requests and their value, (2) termination notices for on-order stocks on contract and their value, and (3) termination notices which resulted in cancellation/termination actions and their value broken out by purchase request and by contract.

The Oklahoma City Center advised the Logistics Command on June 11, 1982, that it could not provide this data because its procedures and practices did not provide for accumulation of on-order termination data in the manner desired. Similarly, the San Antonio Center notified the command on June 17, 1982, that it could not provide on-order termination data broken out by contract or purchase request. However, the Center gave the command composite data for 1981 which showed that 17,418 termination notices had been issued for on-order stocks valued at $193.3 million. Of this total, cancellation action was taken on 494 notices for on-order stocks valued at $7.8 million (4 percent of the total).

CONCLUSIONS

There is a continuing need for improvement in air logistic centers' performance in identifying and canceling excess on-order stocks and an effective system to monitor that performance. The Air Force can still save millions annually in procurement costs by improving its policies, procedures, and practices to insure maximum reduction in excess on-order stocks. It can also alleviate current and anticipated stock fund shortages potentially affecting force readiness.

RECOMMENDATIONS

We recommend that you direct the Commander of the Air Force Logistics Command to:

--Revise its on-order stock termination policy and D062 requirement computation system for system support stock fund items to provide for (1) a 3-month reduction in the on-order stock termination level buffer for items with annual dollar demands of more than $500, (2) elimination of the 12-month stock buffer used to compute termination levels for items with annual dollar demands of $500 or less, and (3) elimination of the use of unfunded war reserve requirements in computing on-order termination levels for all items.

--Require the air logistics centers to establish uniform information systems which will enable management to evaluate the performance of the centers in making maximum reductions in excess on-order stocks. At a minimum, the centers should develop and accumulate statistics showing the number of (1) termination notices for on-order stocks on purchase requests and their value, (2) termination notices for on-order stocks on contract and their value, and (3) cancellations and terminations resulting from these notices and their value broken out by purchase request and by contract.

AGENCY COMMENTS

DOD and Air Force officials concurred in part with our findings and recommendations. They advised us that the Air Force had initiated the necessary system change to eliminate the use of unfunded war reserve requirements when computing the on-order termination level for all items. Also, the Air Force is in the process of establishing a management information system which will enable the Air Force Logistics Command to monitor and evaluate the performance of the air logistics centers in making maximum reductions in on-order stocks exceeding requirements.

DOD and Air Force officials were of the opinion that a reduction in the Air Force's 6-month on-order stock buffer and elimination of its 12-month buffer might result in added administrative costs and increased backorders. They also felt that the Air Force should not be singled out for action in this area since the other services and DLA also employ on-order stock termination level buffers. Therefore, they advised us that the subject of buffer stocks should be addressed DOD-wide. In this respect, DOD will develop a plan by September 30, 1983, outlining the actions that will be taken to develop a standard policy for on-order stock terminations.

DOD's plans to evaluate the on-order stock termination level policies of the other services and DLA has merit. However, we do not feel that it is practical from an economic or supply readiness viewpoint to continue to allow the Air Force to use excessive on-order stock buffers pending the outcome of such a study. DOD's position does not give sufficient recognition to several matters addressed in our report, namely, that the Air Force does not have sufficient funds to purchase needed stocks while at the same time millions of dollars of unneeded on-order stocks are not being identified for possible cancellation.

Also, the Air Force already has a built-in stock buffer of 3 months for medium and high demand items in that it uses a minimum EOQ buy constraint of 6-months, whereas the other services use the 3-month minimum EOQ buy recommended by DOD. Additionally, the Air Force's own study did not support the use of an on-order stock buffer in excess of 3 months.

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As you know, 31 U.S.C. §720 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Secretary of Defense; the Director, Office of Management and Budget; and the Chairmen of the appropriate congressional committees.

Sincerely yours,

Donald J. Horan

Donald J. Horan
Director

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ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

SR

MANPOWER,
RESERVE AFFAIRS
AND LOGISTICS

24 MAR 1983

Mr. Donald J. Horan
Director, Procurement, Logistics and
Readiness Division
General Accounting Office
Washington, D.C. 20548

Dear Mr. Horan:

This is in response to your Letter Report dated February 7, 1983, titled, "Continued Improvements needed in the Air Force Procedures and Practices for Identifying and Cancelling Excess On-order Stocks" (GAO/PLRD-83-36; OSD Case #6140).

Comments received from the Air Force have been considered in preparation of the enclosed response which addresses the findings, conclusions, and recommendations contained in the Letter Report.

Sincerely,

James N. Juliana
Principal Deputy Assistant
Secretary of Defense
(Manpower, Reserve Affairs, and Logistics)

Enclosure
As stated

DEPARTMENT OF DEFENSE
RESPONSE TO GAO LETTER REPORT

"Continued Improvements Needed in the Air Force Procedures and Practices for Identifying and Cancelling Excess On-Order Stocks"
(GAO/PLRD-83-36; OSD Case #6140)

- FINDING A: Air Force policy for computing on-order stock termination levels. As an alternative to GAO's recommendation in a 1979 report (LCD-80-6, October 25, 1979, OSD Case #5224), Air Force changed its policy for computing termination levels for on-order stocks of system support stock fund items (aircraft repair parts and consumables) to provide that on-order stocks exceeding item termination levels be reduced to item requirement objectives, rather than termination levels as was previously done; however, GAO found that the policy change did not provide for identifying and cancelling on-order stocks exceeding item requirements unless the quantity of stock exceeded the termination level. (In connection with this finding GAO points out that Air Force, in responding to the 1979 report, agreed that there was no historical basis for its use of additional levels of stock above requirements as a buffer in computing the termination levels, but declined to eliminate the buffers based on a July 1980 Air Force study showing that its termination policy compared favorably with those of Defense Logistics Agency--DLA--and Army.) (pp. 3-4, GAO Letter Report)

  DoD RESPONSE: Concur. Items are reviewed and potential termination when assets are above the termination level. If the decision is made to cancel the purchase request or terminate the contract, the on-order quantity is reduced so that assets are equal to the requirements objective.

- FINDING B: Air Force did adopt changes in response to the 1979 report. Even though Air Force disagreed with the necessity (identified in the 1979 report) for improving visibility over the performance of air logistics centers in controlling on-order stock excesses, GAO found that Air Force did adopt changes which increased on-order stocks subject to cancellation by $39.4 million (from $92.8 million to $132.2 million) at the Oklahoma City and San Antonio Air Logistics Centers--the two centers at which GAO conducted its follow-up review. (GAO identified the following changes adopted by Air Force: (1) directed logistics centers to place maximum emphasis on prompt cancellation of excess on-order stocks; (2) changed policy to provide for issuance of repeat on-order termination notices on a monthly, rather than quarterly basis; and (3) pending completion (in approximately June 1983) of a planned changeover to update computer hardware and revision of the standard automated system used by logistics centers, directed item managers to manually recompute terminable on-order quantities based on a cutback to item requirement objectives upon receipt of termination notices.) (p. 4, GAO Letter Report)

DoD RESPONSE: Concur.

- FINDING C: Shortcomings in the July 1980 study on which Air Force based its decision to retain additional levels of stock above the requirements objective as a buffer in establishing termination levels. GAO found that Air Force's July 1980 study did not (1) consider the fact that Air Force uses a minimum 6-month buy constraint in computing economic order quantity (EOQ) requirements, whereas the other agencies studied (Army and DLA) use the 3-month minimum EOQ buy constraint recommended by DoD; (2) give consideration to the 12-month stock buffer used in establishing on-order termination levels for items with low annual dollar demands ($500 and under); or (3) highlight in the narrative section of the published study the results which showed that a 3-month stock buffer provides the same protection against uneconomical on-order terminations as a 6-month buffer for items with annual dollar demands above $500. (In connection with this finding, GAO stated that the Command analyst responsible for the 1980 study of comparative economic termination policies confirmed the shortcomings in the study as revealed in GAO's audit.) (pp. 5-6, GAO Letter Report)

  DoD RESPONSE: Partially concur. DoD concurs with items (1) and (2). While item (3) is true, it does not recognize that there were comparisons of other types of buffers and therefore DoD does not concur that the study should be characterized as having shortcomings. The 1980 study was an Air Force study; therefore, it was performed against Air Force items using current Air Force policies. The study did not look at low annual dollar value demand items because the dollar value of any termination action would be less than $500 which would be questionable from an economic viewpoint. In addition, low annual dollar demand items generally have more variable demands which would often lead to repurchase of terminated orders, at higher costs. When comparing the 3 and 6 month buffer, it was necessary to choose the better buffer for further comparison with other types of potential buffers based on such considerations as EOQ and holding costs. The final recommendations contained in the 1980 study did highlight the similarity of results (back orders vs. total inventory costs) for many different policies.

- FINDING D: Potential for increasing the amount of excess on-order stocks subject to cancellation. Based on its computerized retrieval and simulation of data used by the Oklahoma City and San Antonio Logistics Centers to compute system support requirements and on-order termination levels for a quarterly stratification cycle, GAO found that the reduced 3-month stock buffer and elimination of the 12-month stock buffer at only two of the five centers (Oklahoma City and San Antonio) would have increased potential cancellation at the 2 centers by $58.3 million, and that $33.6 million of this increased potential represented purchase request orders that could be cancelled at minimal costs. (GAO used its computer data retrieval system to make a 100 percent computerized analysis of data shown on Air Force tapes to determine the universe of items with assets above termination levels and the related dollar value of on-order stocks exceeding requirements which were (1) on contract and (2) on purchase requests.) (p. 5, GAO Letter Report)

This is fact!

DoD RESPONSE: Concur. It is agreed that reducing the buffer would increase the potential for cancellation. However, this may result in a greater number of backorders and may not be cost effective as many items would have to be reordered soon after cancellation.

This is supposition!

- FINDING E: Air Force Logistics Centers include unfunded war reserve requirements in on-order termination levels. GAO found that the on-order termination levels of the five logistics centers included $28.5 million of unfunded war reserve requirements when, in GAO's opinion, there is no justifiable basis for the routine use of these unfunded requirements as a buffer in establishing on-order termination levels. (In connection with this finding GAO says that the responsible Command data system and system support officials agreed that on-order stocks protected by termination levels are not used to fill or to reduce unfunded war reserve requirements and, therefore, agreed with GAO that there was no justifiable basis for the routine use of these unfunded requirements in establishing on-order termination levels.) (pp. 5-6, GAO Letter Report)

  DoD RESPONSE: Concur.

- FINDING F: Item managers are not cancelling all on-order stock excesses that have been identified as subject to cancellation. GAO found that $39 million, or 26.7 percent, of the on-order stocks reported by the five logistics centers as exceeding termination levels (for the quarter ended December 31, 1981) were still in a purchase request status and therefore could have been cancelled at minimal costs, but for the week ending December 31, 1981, item managers at the Oklahoma City Logistics Center had cancelled less than 5 percent of the excesses identified for the week, and items managers at San Antonio Logistics Center had cancelled less than 6 percent of its identified excesses for the week. (GAO notes that after discussing the problems with center officials, they issued directives to item managers reemphasizing compliance with Air Force regulations, and that the rate of cancellation increased to 14.2 percent at the Oklahoma City center for the week ending March 31, 1982, and increased to 32.9 percent at the San Antonio Center for the week ending September 30, 1982.) (pp. 6-8, GAO Letter Report)

Need for mgmt to [illegible] identified excess cancelling on-order

DoD RESPONSE: Concur. It must be pointed out however, that item managers are not required to cancel all on-order stocks that are identified as subject to cancellation. There are many reasons for items being in this position: (1) fluctuating demand patterns, (2) errors in due-in-assets (system problem where due-ins are not cleared when assets are received), (3) quantity discount buys, (4) life of type buys, (5) contractor minimum quantity buys, etc. Cancellation of on-order stocks is not possible or appropriate for many items because of the above reasons. On many others, it is not economical to terminate because of high termination costs.

True, but when this [illegible] not the case termination costs are [illegible] high, then cancel

o FINDING G: Air Force still has excesses of items for which on-order excesses were identified in the 1979 report. In examining the current inventory posture of 39 sample items with excess on-order stocks at the time of its 1979 review that were not cancelled because of stated continuing need, GAO found that as of July 1982: 11 of the items had stocks on hand in excess of retention levels (7 plus years) which could have been minimized by prior cancellations of excess on-order stocks; the years of supply currently on hand for these items range from 12 or more years for items for which there is still some usage to infinity for items related to aircraft that have been phased out; and the inventory investment costs for the excess stocks of the 11 items amount to about $354,000. (p. 8, GAO Letter Report)

DoD RESPONSE: Without specifics on the individual items, the basis of this finding cannot be verified. However, assuming accuracy of the finding, it is not clear that the total of $354,000 in inventory investment could have been saved (See Finding "F" response).

o FINDING H: Large potential economies available through maximum reduction of excess on-order stocks could offset funding shortfalls. GAO found that Oklahoma City and San Antonio Air Logistics Centers experienced fiscal year 1982 (funding) shortfalls totaling $199 million, but at the time of the review had on-order stocks above termination levels that exceeded requirements by $132.2 million. (GAO notes that Logistics Command officials advised that they were not aware of the large potential economies available through maximum reduction of excess on-order stocks, and that their only visibility over performance of the logistics centers in reducing the excess is the annual stock fund management review, during which they evaluate actions taken by item managers on ten on-order termination notices at each logistics center.) (pp. 8-9, GAO Letter Report)

DoD RESPONSE: Partially concur. The management information system can be improved. However, due to the various reasons provided in the DoD Response to Finding "F" the extent of the economies cited by GAO would probably not be realized.

o FINDING I: Logistics Centers unable to provide complete on-order termination data. After discussion with GAO, Command officials (by letter dated May 27, 1982) emphasized to the centers (the need for) maximum reduction in excess on-order stocks as a means of alleviating current stock fund shortages and the centers were asked to provide 1981 on-order termination data, including (1) on-order stocks on purchase requests and the value of such stocks, and (2) on-order stocks on contract and the value of such stocks. However, Oklahoma City's procedures and practices did not provide for accumulation of the data in the manner desired, and San Antonio could not provide the data broken out by contract or purchase request status. (GAO notes that San Antonio did provide the Logistics Command with composite data for 1981 which showed that 17,418 termination notices were issued for on-order stocks valued at $19.3 million, and cancellation action was taken on 494 notices for stock valued at $7.8 million--4 percent of the total.) (p.9, GAO Letter Report)

DoD RESPONSE: Concur.

CONCLUSIONS

o CONCLUSION 1: Continuing need for improvements in cancelling excess on-order stocks (and identifying the amount subject to cancellation). In connection with Findings A and B, GAO concluded that the actions taken by Air Force in response to the 1979 report are a step in the right direction, but additional improvements are needed to maximize reductions in excess on-order stocks. (GAO says its followup review showed that Air Force can realize additional savings of $58 million or more a year by (1) reducing on-order termination level stock buffers which are unreasonably high and eliminating those that are not justified and (2) establishing a system for monitoring and evaluating the performance of logistics centers in controlling on-order stock excesses--see, Finding D.) (p. 4 and P.9 GAO Letter Report)

OSD RESPONSE: Partially concur. It is agreed that additional improvements are needed, DoD-wide, but believe that some buffers will continue to be required.

o CONCLUSION 2: Need for a reduction in some on-order termination level stock buffers and elimination of others. In connection with Findings C through E, GAO concluded that Air Force could reduce its 6-month stock buffer by 3 months without impacting on force readiness, and that the 12-month stock buffer for low annual dollar demand items ($500 and under) could be eliminated without compromising supply effectiveness since more than adequate protection against uneconomical terminations and stockouts is provided by a 3-year EOQ buy and a $2,500 threshold for contract termination which alone provides a supply equivalent to 5 years' demand. (p. 5, GAO Letter Report)

OSD RESPONSE: Nonconcur. Reduction of the buffer from 6 months to 3 months could result in erroneous cancellation of orders which subsequently would have to be reordered. This could result in loss of leadtime and increased backorders. Many of these items have extremely variable demand patterns. The purpose of the 6 month buffer is to minimize the vacillation of items between buy and termination positions. Air Force believes that eliminating the buffer for low annual demand items would be even more chaotic. The slightest drop in demands could cause the reduction or cancellation of low dollar buys which would very often have to be reordered the next computation cycle.

- CONCLUSION 3: Need for system for monitoring the performance of logistics centers in cancelling on-order excesses. In connection with Findings F through G and I, GAO concluded that maximum reductions in excess on-order stocks were not being achieved at the San Antonio and Oklahoma City centers because item managers often (1) did not reduce excess on-order stocks exceeding termination levels to item requirement objectives; (2) erroneously applied the dollar threshold criteria for contract termination ($2,500) to on-order excesses that were still in a purchase request status; and (3) made routine certifications that it was uneconomical to cancel contracted quantities of on-order excesses because of continuing need without benefit of a detailed analysis of supply status, usage trends and holding versus termination costs. (GAO sets forth three specific examples in support of this conclusion.) (pp. 6-7, GAO Letter Report)

DoD RESPONSE: Concur.

- CONCLUSION 4: Maximum reductions in on-order excesses needed to alleviate funding shortfalls. In connection with Finding H, GAO concluded that improvement in Air Force's procedures and practices for maximum reduction of on-order stock excesses is especially appropriate at this time because of current and anticipated shortfalls in Air Force's 1982 and 1983 stock fund obligational authority.

DoD RESPONSE: Concur. However, the economies are not expected to be as great as cited in the GAO Report (See DoD Response to Findings F, G, and E.)

RECOMMENDATIONS

- RECOMMENDATION 1: GAO recommended that the Secretary of the Air Force direct the Commander of the Air Force Logistics Command to revise its on-order stock termination policy and D062 requirement computation system to provide for (1) a 3-month reduction in the

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on-order stock termination level buffer for items with annual dollar demands of more than $500; (2) eliminate the 12-month stock buffer used to compute termination levels for items with annual dollar demands of $500 or less; and (3) eliminate the use of unfunded war reserve requirements in computing on-order termination levels for all items. (p. 10, GAO Letter Report)

DoD RESPONSE: Partially concur. The Department nonconcurs with items (1) and (2). The Draft Report singles out the Air Force when, in fact, all Services and DLA compute a buffer stock level of some type. For example, the Army computes a buffer level for items with less than $500 annual demands which, based on economic considerations, could result in the continued procurement of 18 months of stock above the requirements objective for items on purchase request and as much as 3 years for items on contract. Therefore, the subject of buffer stocks should be addressed DoD-wide. In this respect, OASD(MRA&L) will develop a plan by September 30, 1983 which outlines the actions that will be taken to develop a standard policy for determination of when to reduce on-order procurement quantities.

The Department concurs with item (3). The Air Force has initiated the necessary systems change to eliminate the use of unfunded war reserve requirements when computing the on-order termination level for all items. Implementation of the systems change is scheduled for June 1984.

o RECOMMENDATION 2: GAO recommends that the Secretary of the Air Froce direct the Commander of the Air Force Logistics Command to establish a management information system which will enable the Command to periodically monitor and evaluate the performance of its air logistics centers in making maximum reductions in on-order stocks exceeding requirements. At a minimum, this information system should entail accumulating and reporting statistics at least quarterly showing (1) the number of termination notices for on-order stocks on purchase requests and the value of such stocks; (2) the number of termination notices for on-order stocks on contract and the value of such stocks; and (3) the number of termination notices which resulted in cancellation/termination actions and the value of such actions broken out by purchase requests and by contracts. (p. 10, GAO Letter Report)

DoD RESPONSE: Partially concur. The Department concurs that a management information system is required. The Air Force will establish a management information system by October 1983 which will enable the Air Force Logistics Command to monitor and evaluate the performance of the air logistics centers in making maximum reductions in on-order stocks exceeding requirements. The centers are required to set up review teams and make quarterly reviews of randomly selected items to determine the validity of on-order decisions. The results of these reviews will be provided to the Headquarters, Air Force Logistics Command. The Department does not concur with the reporting system as recommended by the GAO because it would require excessive manual workload and would not provide the data required to evaluate compliance with Air Force policy.