

247-3  
121204

UNITED STATES GENERAL ACCOUNTING OFFICE

Washington, D.C. 20548

FOR RELEASE ON DELIVERY  
Expected at 10 a.m., EST  
Wednesday, April 27, 1983

Statement of  
Henry W. Connor, Senior Associate Director  
Procurement, Logistics and Readiness Division  
before the  
House Armed Services Committee  
Subcommittee on Readiness  
on  
Progress Made by the Navy in Improving  
Physical Inventory Controls and the  
Magnitude, Causes and Impact  
of Physical Inventory Adjustments  
in the Army, Air Force, and  
Defense Logistics Agency



121204

025397

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of work performed at your request, Mr. Chairman. GAO was requested to (1) monitor the Navy's progress in developing and executing a plan of action to improve physical inventory controls over supply system inventories; (2) investigate physical inventory adjustments, their causes and impact within the Army, Air Force and Defense Logistics Agency; and (3) evaluate the adequacy of related DOD policies, procedures and efforts to improve physical inventory controls and inventory record accuracy.

NAVY'S PROGRESS IN IMPROVING  
PHYSICAL INVENTORY CONTROLS

The Navy has developed and is making good progress in executing a plan of action to improve physical inventory controls. The Navy has completed an immediate action designed to establish accurate inventory record baseline data for supply system inventories. This special physical inventory effort which covered all 6 supply centers was completed in December 1982 and resulted in inventory gains and losses totaling \$439 million. Unrecorded materiel valued at \$239 million was located and recorded materiel valued at \$200 million could not be found.

Additionally the Navy has developed and is in the process of completing action on 73 other initiatives designed to bring about permanent improvements in physical inventory controls and inventory record accuracy.

As a part of these initiatives inventory management is now receiving top command priority and emphasis. The Naval Supply Systems Command now has a flag officer responsible for inventory and system integrity. Let me mention a few other important initiatives.

Clear guidance has been provided to supply activities that falsified reporting will not be tolerated and that the strongest disciplinary actions will be taken if found. A mandatory entry on inventory accuracy and materiel accountability is now required in the fitness reports of supply corps officers and in the merit pay objectives/performance evaluations of supervisors and foremen involved in functions affecting inventory accuracy.

Also, the Navy has begun to take actions to strengthen physical security safeguards at supply centers. These actions estimated to cost \$2.3 million include increasing the size of security forces, increased covert warehouse operations by Navy investigative personnel, restriction of access to warehouses by establishing a security badge identification system and constructing security fencing.

Additionally, the Navy has taken actions to develop new computer programs and modify existing programs at a cost of \$1.2 million to assist supply centers in reducing the time required to research and reconcile physical inventory discrepancies. The Navy also has initiated actions to increase the size of quality assurance teams at supply centers and to expand the scope of quality checks of work processes affecting inventory record accuracy.

In our opinion, the positive actions taken by the Navy, if properly implemented and pursued continuously, should bring about long-term and sustained improvements in physical inventory controls and inventory record accuracy.

MAGNITUDE, CAUSES AND IMPACT OF INVENTORY  
ADJUSTMENTS--ARMY, AIR FORCE, DLA

In fiscal year 1982 the Army, Air Force and DLA spent an estimated \$50 million on their physical inventory programs. During the past 5 fiscal years the value of gross physical inventory adjustments reported by the Army, Air Force and DLA decreased from \$1.5 billion to \$1.3 billion (losses dropped from \$778 million to \$690 million). Conversely, the value of materiel inventoried increased from \$30 billion to \$43 billion. As a percentage of the value of materiel inventoried, the gross physical inventory adjustments decreased from 5 percent to about 3 percent, as compared to varying agency standards ranging from 4 to 8 percent.

Accuracy and completeness of reported  
physical inventory adjustments

Our review indicates that the value of physical inventory adjustments reported to DOD understates the true extent of inventory record inaccuracies by billions of dollars annually. Under existing policy and procedures, significant stock record imbalances could exist for up to a year without being reflected in statistics which are

considered indicative of inventory record accuracy performance by DOD and its components. Additionally, required physical inventory adjustments are not made in many instances because of erroneous reconciliations of valid physical inventory variances.

DOD's policy provides for reversals of physical inventory adjustments within 90 days if follow-up causative research reveals that they are due to prior erroneous transactions (i.e. earlier erroneous physical inventory adjustments, duplicate receipts or issues). Physical inventory adjustments which are reversed are eliminated from the reported cumulative statistics which are viewed by management as an indicator of whether inventory record accuracy goals are being met.

Contrary to DOD policy, DLA's implementing procedures allow a 1-year timeframe for reversals of physical inventory adjustments. Additionally, the implementing procedures of the Air Force and Army allow for correction of major physical variances by means other than physical inventory adjustments if preadjustment research indicates that the variances are attributable to earlier erroneous transactions that occurred within the past year, as opposed to DOD's policy of limited preadjustment research of recent transactions.

Details of our findings are contained in a separate supplement which we have given to the Subcommittee. Therefore I will limit my comments to a brief summary of the findings.

## Air Force

The Air Force reported physical inventory adjustments of \$215 million and \$300 million, respectively, for fiscal years 1981 and 1982. Physical inventories taken at the 5 air logistics centers for these fiscal years revealed inventory record variances valued at \$2.6 billion and \$4.2 billion, respectively. These variances represented 29.8 percent and 36.2 percent of the value of materiel inventoried. According to Air Force records, approximately 92 percent of the value of these physical inventory variances were resolved without making or reporting physical inventory adjustment transactions. Our review indicates that only about 5 percent of these physical inventory variances were legitimately reconciliable and correctible by means other than physical inventory adjustments.

Our review and Air Force audit reports indicate that erroneous reconciliations of inventory variances are frequently made arbitrarily to avoid making and reporting major physical inventory adjustments.

For example, an August 1982 physical inventory of an aircraft engine fan blade (stock number 2840-01-004-1804) located 138 unrecorded blades valued at \$401,580. Preadjustment research completed in October 1982 concluded that this gain occurred because 52 issues of these 138 items recorded over a 1-year period had not actually been shipped. Thus, the variance was considered resolved and the item's recorded balance was corrected by reversing the 52 issues. Our analysis of depot shipping records showed that the 52 issues in question had been shipped. As a result of

the invalid preadjustment research, a physical inventory gain adjustment of \$401,580 was erroneously avoided.

Erroneous reconciliations of major inventory variances to avoid physical inventory adjustments is a continuing problem in the Air Force. In 1971, we reported that 49 percent of required adjustments for active, high-dollar items were not made by 3 air logistics centers because of erroneous reconciliations.

### Army

The Army reported physical inventory adjustments totaling \$904 million and \$790 million, respectively, in fiscal years 1981 and 1982. The reported statistics do not include physical inventory adjustments which were subsequently reversed or potential major physical inventory variances which were resolved by means other than physical inventory adjustments.

Although required by DOD and Army policy, we found that data on reversals of physical inventory adjustments at the Army's 5 materiel commands was not readily identifiable. However, a computerized analysis of transactions for the past 2 years at the Tank-Automotive Command revealed reversals totaling \$592 million and \$108 million in fiscal years 1981 and 1982.

In fiscal year 1981, the Tank-Automotive Command's reported gross physical inventory adjustment ratio after reversals was 19.4 percent as compared to an Army standard of 8 percent. The adjustment ratio prior to reversals was 43.4 percent. Also, in fiscal year 1981, this activity

reported a net physical inventory gain of \$67 million after reversals. Had the reversals not been made a net loss of \$464 million would have been reported.

Our review and Army audit reports indicate that required physical inventory adjustments are not made in many instances because of erroneous reconciliations of valid physical inventory variances. In this respect, the New Cumberland Army Depot completed preadjustment research of 1,435 potential major physical inventory variances (variances valued at over \$10,000 or for controlled items) in 1982. For 52 percent of the major variances researched, depot personnel concluded that no adjustments were necessary. We tested 8 major variances for which no adjustments were made and found that in 6 cases, or 62 percent, a major adjustment should have been made.

For example, a June 1982 physical inventory revealed a shortage of 41 diesel engines having a unit price of \$7,658. This 1200-pound diesel engine (stock number 2815-01-098-5763) which is classified as a mission essential item is used on the M561 tactical truck. Preadjustment research completed in August 1982 concluded that an overage of 5 engines existed instead of a shortage. Notwithstanding, the variance was considered reconciled and no adjustment was made. Another physical inventory taken by depot personnel in December 1982, revealed a shortage of 15 engines. This shortage was not subjected to the required preadjustment research and no adjustment was made.



A subsequent physical inventory taken by us in January 1983, confirmed by depot personnel, revealed that there were 15 fewer engines on hand than shown on depot records. Moreover, the depot had 103 fewer engines valued at \$788,774 on hand than reflected on the accountable records maintained by the Tank-Automotive Command. Depot personnel initially concluded that the subject engines had been mixed in stock with another engine, (stock number 2815-00-124-5390) stored nearby. This conclusion was based on an overage of 20 units of the other engine (u.p. \$10,425) revealed by a February 1983 physical inventory. However a subsequent physical inventory taken by depot personnel, and monitored by us, revealed no such mixture of engine stocks.

In response to our inquiries, depot records were adjusted in February 1983 to reflect a loss of 15 diesel engines valued at \$114,870 and a gain of 20 units of the other engines valued at \$208,500. Also, the depot reported its physical counts of these 2 engines to the Tank-Automotive Command.

An Army audit report issued in January 1981 cited weaknesses in physical inventory controls at the Letterkenny Army Depot. The report noted that in 90 percent of the cases sampled, required physical inventory adjustments were not made for controlled items because of erroneous reconciliations. The report concluded that physical inventory differences were often arbitrarily reconciled to agree with recorded balances.

Defense Logistics Agency

DLA reported physical inventory adjustments totaling \$247 million and \$290 million, respectively in fiscal years 1981 and 1982. The reported statistics did not include physical inventory adjustments which were subsequently reversed. We found that the 5 Defense supply centers reversed physical inventory adjustments valued at \$353 million and \$548 million, respectively, in fiscal years 1981 and 1982. The physical inventory adjustments for these supply centers after reversals represented a gross dollar adjustment ratio of 6.3 percent and 5.8 percent in fiscal years 1981 and 1982 as compared to a DLA standard of 5 percent. Prior to reversals the gross physical inventory dollar adjustment ratios were 31.5 percent and 39.9 percent, respectively.

DLA's policy for reversals of physical inventory adjustments is more liberal than that prescribed by DOD and implemented by the services. DLA's policy and practices allow 1 year for reversals of physical inventory adjustments, whereas DOD's policy prescribes a 90-day timeframe for such reversals.

Also, DLA's policy and practices provide for dual reversals of offsetting adjustments. This is not consistent with DOD policy which stipulates that reversals of prior physical inventory adjustments will not be permitted if an inventory has been conducted between the date of the original adjustment and the date reversal action is attempted. For example, in October 1981, the Defense General Supply Center recorded a physical inventory loss

adjustment for 1935 cable assemblies valued at \$31,250. In January 1982, the center recorded a physical inventory gain of 1,330 cable assemblies valued at \$21,480. On the basis of its postadjustment research, the center determined that the gain was attributable to the prior loss adjustment which was made in error.

In connection with the earlier physical inventory, the supply center recorded a receipt of 1935 units after establishment of the inventory cutoff date but prior to completion of the inventory. As of the cutoff date, the stock records showed a zero balance. The day after recording the receipt, the supply center received a physical count quantity of zero. Inasmuch as the recorded balance and physical count both showed zero as of the established cutoff date, no adjustment was necessary. However the center erroneously wrote off as a loss, the receipt of 1,935 units which had been recorded a day earlier. Even though the gain adjustment of 1,330 units corrected the stock record, subsequent offsetting entries were recorded to reverse the gain and 1,330 units of the original loss adjustment.

Impact of inventory record inaccuracies on supply economies and readiness

Our review and agency audits show that continuing inventory record inaccuracies frequently have an adverse impact on supply economies and readiness.

Defense Logistics Agency

At the Defense General Supply Center we randomly selected and analyzed the circumstances involving reversals

of 85 major loss adjustments which occurred in fiscal year 1982. In 16 of the cases, or about 19 percent, the temporary losses of materiel resulted in delays ranging up to 407 days (averaging over 50 days) in filling 164 requisitions. Of the 164 delayed requisitions, 44 were to satisfy high-priority needs including 9 for materiel affecting mission capability. Also, these temporary losses resulted in premature or unnecessary procurements valued at \$34,795.

Additionally, we identified 121 high-priority requisitions for mission essential items which were delayed in fiscal year 1982 because of inaccurate inventory records. Our sampling tests showed that delays up to 60 days occurred in filling these requisitions because stock on hand was not shown on inventory records.

Examples of the 130 delayed requisitions affecting mission capability identified by GAO are presented in the separate supplement.

A Defense Audit Service report currently being processed shows that the Defense Personnel Support Center unnecessarily procured an estimated \$1.2 million of subsistence items in one year because of inaccurate inventory records. This occurred because the center relied on infrequent physical inventories to correct its records for nonperishable subsistence items consigned for overseas shipments, rather than recording transactions as they occurred.

### Air Force

Air logistics centers have a critical item program for managing items which adversely affect mission capability for prolonged periods (2000 hours or more). At the San Antonio Air Logistics Center we identified a number of critically managed items which had gotten in this status because of a shortage of available assets.

We reviewed the transaction histories for these items and randomly selected 7 items for which physical inventory losses had been recorded in the past year. We found that the inventory losses directly caused the critical status of 4 mission essential items and aggravated the criticality of the other 3 mission essential items.

In one case, three physical inventory losses over a 35-day period in 1982 aggravated the critical supply status of a cable assembly used on the C141 aircraft. At the time of our review 40 C141 aircraft were grounded because of the shortage of cable assemblies. Additional details and examples are provided in the separate supplement.

### Army

At the New Cumberland Army Depot, we randomly selected and reviewed 18 major physical inventory loss adjustments which had been reversed during a quarterly period ending in October 1982. We found that 10 of these erroneous loss adjustments, or 55 percent, had resulted in losses of materiel up to 5 months with resultant delays in filling high-priority requisitions up to 3 months.

An Army audit report issued in January 1982 criticized the Tank-Automotive Command for delays in researching and reversing significant erroneous inventory loss adjustments. The report concluded that as much as \$110 million of inventory losses recorded by this command in fiscal year 1981 may have been invalid and that 50 percent of the invalid loss adjustments sampled adversely impacted on either procurement economies or supply effectiveness.

Effectiveness of policies and practices  
for identifying and correcting major  
recurring causes of inventory errors

The procedures and practices of the Army, Air Force and DLA are generally not effective in identifying and correcting the causes of recurring major inventory record errors. Error trends are either not identified or, if identified not acted upon and corrected. These conditions are attributable to procedural weaknesses, a shortage of qualified personnel, and inadequate management emphasis and priority.

DOD policy and the implementing procedures of the Army, Air Force and DLA provide for quality control programs and causative research as the primary means of identifying and correcting those human, procedural, or system errors which adversely affect inventory record accuracy.

Quality control programs involve periodic sampling accuracy checks of work processes directly related to physical control of assets (i.e. receiving, issuing, warehousing, physical inventory taking, and related adjustment of records). Causative research is required for

all physical inventory adjustments involving classified and sensitive items; adjustments greater than \$2,500 for pilferable items and adjustments greater than \$10,000 for other items. This research consists of a complete review of all transactions, catalog data changes, warehouse location changes, and unposted or rejected documentation occurring since the last physical inventory or back one year, whichever is sooner.

### Army

In fiscal year 1982 the Tank-Automotive Command was unable to determine a reason for 73 percent of the more than 12,000 major variances researched. The remainder was attributed to depot warehouse location problems. However, no followup was made with the depots to identify and correct the causes of this problem.

At the New Cumberland Army depot our review indicated that a primary cause of materiel location problems was the constant rewarehousing of stocks. This activity was making over 3,000 location changes ~~weekly~~<sup>monthly</sup> due to saturation of available storage space with inactive item stocks. As a result materiel was frequently mislocated for prolonged periods. Quality control checks performed at this depot noted repeated problems involving inaccurate physical counts and delays in or failure to record materiel location changes. Although these problem areas were repeatedly reported to depot officials, effective corrective action was not taken to prevent a recurrence. The quality control results and feedback on corrective action taken were not reported to the depot commander or higher Army authority.

At the Tank-Automotive Command prescribed quality control coverage did not include the accuracy of pre- and post- adjustment research results and related reconciliations of major inventory variances and reversals of major physical inventory adjustments. At the New Cumberland depot, statistics compiled for a recent 21-month period showed that required monthly checks of the accuracy of adjustments made to depot locator records were not made for 18 of the 21 months. Also, required checks of the accuracy of location record reconciliations were not made for 13 of the 21 months. Justification cited for frequently not making required key quality control checks was lack of adequately trained personnel and higher priority assignments.

The Army's Materiel Development and Readiness Command has recognized the need for providing more management emphasis and priority to the quality control program. In January 1983, materiel commands and depots were directed to comply with prescribed quality control procedures and to submit monthly quality control reports to command headquarters.

#### Air Force

In fiscal years 1981 and 1982, the 5 air logistics centers could not determine a reason for 43 percent and 39 percent, respectively, of the major physical inventory variances researched. At the San Antonio center, research performed in fiscal years 1981 and 1982 showed that prior erroneous physical inventory adjustments and delays in or



failure to report physical count results accounted for 20 percent of the major variances. However, no apparent follow-up action was taken to correct these problems.

We found that major inventory variances caused by delays in or failure to report count results were due to a correctable Air Force-wide system problem which local management had been aware of for at least 3 years. In this respect the standard automated inventory system at the centers is programmed to reduce to zero the balances of items subjected to scheduled physical inventories if completed count cards are not input to the system within 30 days after the established inventory cutoff date.

Supply officials cited the following reasons for shortcomings in correcting primary recurring causes of major physical inventory variances:

- Air Force guidance on the objectives of inventory research is unclear. Local management's efforts to obtain clarification and more detailed guidance from the Air Force Logistics Command has been unsuccessful.
- Research analysts and item managers lack adequate training to conduct timely and accurate inventory research.
- The Air Force's goal of 14 days for completing preadjustment research does not allow sufficient time to accomplish thorough research.
- Turnover among item managers is unusually high, estimated at about 60 percent in a recent year.

Defense Logistics Agency

In fiscal years 1981 and 1982, the Defense General Supply Center was unable to determine a reason for 26 percent and 28 percent respectively, of the major physical inventory variances researched. Although causative research at this center indicated that erroneous warehouse denials and inaccurate physical counts at depots were responsible for 52 percent and 41 percent, respectively, of major physical inventory adjustments in fiscal years 1981 and 1982, no apparent follow-up action was taken with the depots to identify or correct the primary causes of these problems. Officials at this center felt that the primary purpose of causative research was to identify and reverse erroneous physical inventory adjustments, rather than resolving the primary causes of recurring major discrepancies.

DLA requires its depots to perform quarterly quality control checks of 17 operations affecting inventory record accuracy. However, contrary to DOD policy, DLA does not require its supply centers to perform quality control checks. Thus, the accuracy of physical inventory adjustments, causative research and related reversals of adjustments are not subjected to quality assurance tests.

We found that DLA depots do not perform all of the required quality control checks because of a shortage of quality assurance specialists. Also, these depots frequently do not meet quality assurance standards. In both

fiscal years 1981 and 1982, the Richmond depot failed to meet acceptable quality control standards for 12 of 17 inventory operations. Also, this depot's performance in some areas decreased from fiscal year 1981 to 1982. For example, inventory count accuracy decreased from 91.5 percent to 86.9 percent, as compared to an acceptable quality rate of 98.5 percent. Also, in fiscal year 1982 this depot did not perform required quality control audits for 3 of the 17 operations because of a shortage of quality assurance specialists.

In May 1982, the DLA director became concerned with the Richmond depot's high materiel release order denial rate and directed that the necessary corrective actions be taken. As a result, this depot is now performing monthly quality control audits for 6 of the 17 operations (i.e., inventory count accuracy, requisition denial processing). Also, the depot quality control team is now taking a 100 percent verification of locator record data input.

- - - - -

The high rate of reversals of physical inventory adjustments and erroneous reconciliations of valid major physical inventory variances disclosed by our review and prior agency audits is indicative of both poor physical inventory performance and serious inventory control problems. Accordingly, we believe that the magnitude of the inventory accuracy problem in DOD is much greater than previously recognized. GAO also believes that data on reversals to physical inventory adjustments and corrections

of valid physical inventory variances by means other than physical inventory adjustment should be viewed equally with physical inventory adjustments by management in evaluating overall inventory accuracy performance.

DOD'S PLANS FOR IMPROVING PHYSICAL INVENTORY CONTROLS

In early 1982 the Defense Council on Integrity and Management Improvement designated physical inventory control as an issue that required immediate management attention and corrective actions. The Council expressed concern with the increasing trend of physical inventory adjustments, totaling over \$2 billion in fiscal year 1981, and felt that not enough effort had been dedicated to identifying and correcting error causes.

The Council established a plan of action for improving physical inventory controls. Under this plan, DOD's Joint Physical Inventory Working Group was tasked with identifying and implementing improvements needed in policies, procedures and standards for achieving and sustaining an acceptable level of inventory record accuracy for supply system inventories. Also, the military services and DLA were directed to upgrade the command priority and emphasis given to their physical inventory programs and to assess the additional resources needed to improve performance.

A physical inventory control improvement program plan was developed in June 1982 by DOD's Joint Physical Inventory Working Group. This plan calls for a series of actions during fiscal years 1982 through 1985 to identify

and implement improvements needed in policies, procedures and standards for upgrading physical inventory performance and inventory record accuracy. Specifically, the plan provided for:

- expedited approval and publication by December 1982 of previously proposed changes to improve DOD's physical inventory procedures.
- review of actions currently being taken by the Navy to upgrade inventory record accuracy and identification of those improvements deemed advantageous for adoption throughout DOD. This action was targeted for completion in September 1982.
- on-site visits during February through April 1983 to 10 depot and inventory control activities by members of the Joint Physical Inventory Working Group to evaluate actual performance. These visits will provide baseline data for developing additional procedural changes. Also, these on-site reviews will serve as a prototype for establishing a permanent program of periodic review by DOD components and the Joint Physical Inventory Working Group of physical inventory procedures and practices.
- validation of existing performance standards and development of new or revised standards. This action is to be accomplished by September 1983.
- review of physical inventory techniques used by DOD components and an assessment of the impact of increasing the percentage of items to be inventoried each year. This action is targeted for completion by July 1985.

--development of new procedural requirements and techniques to relate impact of physical inventory adjustments to requirement determination and procurement. The milestone for accomplishing this action is July 1985.

As a part of this plan, the Chairman of the Joint Physical Inventory Working Group is to provide periodic progress reports to the Director, Supply Management Policy, OASD (MRA&L). The first progress report was due in September 1982 with ensuing reports due every 6 months thereafter.

We met with the chairman and other members of DOD's Joint Physical Inventory Working Group in January 1983 in an effort to evaluate the adequacy of the progress being made in accomplishing the physical inventory improvement program plan. At this time the Group had not submitted its first progress report which was due in September 1982. The only completed action taken which could be evaluated by us was the publication of proposed changes to DOD's physical inventory procedures which are scheduled for implementation by December 1983.

We noted a number of benefits and shortfalls in the proposed procedural changes as related to problem areas surfaced by this audit. The benefits noted included:

--establishment of expanded inventory error classification codes broken out by types of operation in which the error occurred (i.e. receiving, issuing, physical inventory, warehousing).

--expanded quality control coverage to include accuracy checks of (1) recorded materiel location changes following major rewarehousing projects and (2) causative research results and related physical inventory adjustments and reversals thereto made by both depots and inventory control points.

--Revision of the inventory control effectiveness report compiled quarterly by DOD and used to measure comparative physical inventory performance of the services and DLA. The revised report will include data on reversals made to prior quarters' physical inventory adjustments. Also, when performance goals are not achieved the report will be accompanied by narrative analysis of major error causes and corrective action initiated.

While the proposed changes provided for disclosure of reversals made to prior quarters' physical inventory adjustments which were used to reduce cumulative reported physical inventory adjustments, they did not reveal the extent to which reversals made in the current quarter were used to reduce physical inventory adjustments reported for the current quarter. Also, the proposed changes did not require that reversals be viewed as a management indicator of the quality of physical inventory performance.

On April 11, 1983, members of the Readiness Subcommittee staff and GAO jointly briefed representatives of DOD of the results of the subject assignment. At this meeting DOD provided us with the latest proposed changes

dated March 1983 to DOD's physical inventory procedures. The proposed changes which are scheduled for implementation by October 1984 now provide for reporting and full disclosure of reversals made to physical inventory adjustments.

Also, we are opposed to the proposed change to increase the timeframe for reversing physical inventory adjustments from 90 days to one year. In our opinion such a change will only contribute to more time consuming and futile causative research and will encourage additional arbitrary reversals for the sole purpose of minimizing reported physical inventory adjustments.

Additionally, we view as a shortcoming the proposed change to increase the mandatory dollar criteria for complete causative research of physical inventory adjustments of pilferable items from \$2,500 to \$4,000. This change was arbitrarily made without benefit of a study. Our review indicated that the average adjustments for pilferable items is under \$4,000 at a majority of inventory control points. Thus, implementation of this change would reduce the effectiveness of research to detect and deter unauthorized diversion of pilferable items.

With the exception of the shortcomings noted above, we believe DOD's plan of action for improving physical inventory performance and inventory record accuracy is a positive one. However, we are concerned with the slippage noted in implementing this plan.