



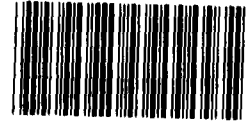
UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

JANUARY 10, 1984

B-213652



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Vice Admiral Eugene A. Grinstead
Director, Defense Logistics Agency

Dear Admiral Grinstead:

Subject: Defense Logistics Agency Could Better Identify
and Cancel Unneeded On-Order Material
(GAO/NSIAD-84-42)

We have reviewed the Defense Logistics Agency's (DLA's) procedures and practices for identifying and canceling unneeded on-order material. We found that DLA supply centers do not effectively identify and cancel such material, and the practices followed contribute to unnecessary procurement costs and/or inventory investment.

Within its automated stock control system, DLA has established a review level which, when exceeded, alerts item managers that on-order stocks may be unneeded and may need to be canceled. Item managers are supposed to review the cancellation notices and take appropriate action.

At the Defense Industrial and Electronics Supply Centers, \$1.7 million of unneeded on-order material should have been canceled but was not because of ineffective internal controls to monitor cancellation decisions. As a result of our inquiries, the centers canceled \$654,880 of excess on-order material. But we believe that most of the \$1.7 million in excessive planned procurements could have been routinely canceled if the centers had had better internal controls.

We also found that (1) when management responsibility for items is transferred to DLA--such as the recent transfer of selected consumable items from other services--DLA managers do not adequately consider procurement actions started by the other services but not completed at the time of transfer and (2) the criterion used by DLA managers to determine cancellation levels

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allows stockage of inventories above system requirements (buffer stocks) at unreasonably high levels. Our findings are discussed in detail in enclosure I.

To reduce unnecessary inventory investment and achieve better use of stock fund resources, DLA needs to (1) establish internal controls to monitor inventory managers' performance in maintaining optimum stockage levels and (2) modify its procedures and practices for identifying and canceling excessive on-order material.

RECOMMENDATIONS

We recommend that you direct the centers to establish controls for monitoring and evaluating item manager performance in canceling unneeded on-order material. As a minimum, such controls should insure that supervisors routinely review item manager decisions on cancellation notices. By doing this supervisors could review, even if on an exception basis, the cancellation or noncancellation action and the item manager's justification for it.

We also recommend that you revise the program for computing system due-in review levels to

- consider all types of dues-in from procurement equally unless it has been absolutely determined that they are invalid and
- limit the amount of buffer stocks included in the determination of cancellation levels. One way this can be done is to adjust the procurement cycle percentage in relation to the length of the procurement cycle.

AGENCY COMMENTS

On November 7, 1983, we met with Department of Defense and DLA officials to discuss a draft of this report. They concurred in our findings and conclusions and cited actions, planned or in process, to implement our recommendations. The full text of their comments is included as enclosure II to this report.

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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 House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate

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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; the Chairmen of the above-named Committees; and the Chairmen, House and Senate Committees on Armed Services.

Sincerely yours



Frank C. Conahan
Director

Enclosures - 2

DEFENSE LOGISTICS AGENCY COULD BETTERIDENTIFY AND CANCEL UNNEEDED ON-ORDER MATERIALINTRODUCTION

To carry out inventory management at its supply centers, DLA has established the Standard Automated Material Management System (SAMMS). This connects the centers' distribution, requirements, contracting, and financial subsystems and provides necessary data for uniformly managing DLA's stock fund inventories.

DLA has established procurement cycles for items based on value and demand for them. Procurement cycles included in SAMMS are expressed in months and are derived using economic order quantity computations. Medium and high dollar value items have procurement cycles ranging from a 3- to a 22-month supply.

The system includes a due-in review level for all medium and high dollar value items. This level consists of item requirements through the procurement cycle plus a percentage of the procurement cycle--currently 50 percent at most centers. Each month the system compares this review level with available assets, both on hand and due in. When available assets exceed the review, or cancellation level, and their value exceeds the economic dollar restriction for cancellation actions established by the center, the system alerts the item manager, identifies the on-order stocks that are unneeded, and recommends cancellation. The system generates another cancellation notice on the next monthly cycle if excessive on-order stocks still exist.

Item managers are supposed to review cancellation notices and take appropriate action. Possible actions include:

1. Reducing or canceling the recommended buy.
2. Reducing or canceling the purchase request.
3. Reducing or canceling the contract.
4. Taking no cancellation/termination action.

Inventory managers are supposed to base their decisions on knowledge of the items; i.e., their nature, demand trend, and other applicable information. Managers are also supposed to fully document decisions to take no action.

The quantity to be canceled/decreased is the difference between the total assets (on hand and due in) and total requirements through the procurement cycle (stockage objective requirement). In other words, on-order stocks exceeding the system due-in review level should be cut back to the stockage objective requirement.

OBJECTIVE, SCOPE, AND METHODOLOGY

Our primary objective was to determine whether DLA's procedures and practices for identifying and canceling unneeded on-order material were effective and whether they contributed to unnecessary inventory investment and/or procurement costs. We did our work at the following activities between July 1982 and April 1983:

- DLA, Cameron Station, Virginia.
- The Defense Industrial Supply Center (DISC), Philadelphia, Pennsylvania.
- The Defense Electronics Supply Center (DESC), Dayton, Ohio.

We reviewed material management policies and procedures included in DLA's Material Management and Supply Operations Manuals. The procedures are applicable at all centers where supply transactions are processed by SAMMS. This includes the four "hardware" centers¹ and medical supplies at the personnel support center in Philadelphia.

Specifically, we focused on policies and procedures for (1) computing cancellation levels for replenishment demand items and (2) identifying and canceling excessive on-order stocks. To test the efficiency of the policies and procedures, we reviewed and evaluated the cancellation practices at DESC and DISC. We also interviewed DLA officials and reviewed internal audit reports.

At the centers visited, we obtained computer tapes containing all items with open purchase requests that were in an over-procurement status as of September 30, 1982. We concentrated on items still in a purchase request stage so that, as of our review, the centers would have had sufficient time to have

¹/DESC, Dayton, Ohio
Defense Construction Supply Center, Columbus, Ohio
DISC, Philadelphia, Pa.
Defense General Supply Center, Richmond, Va.

identified and corrected the excess on-order condition before contract award or, if the contract had been awarded, before delivery of the material. We used standard computer programs to retrieve and stratify data, as follows:

<u>Overprocurement amount per item</u>	<u>No. of items</u>			<u>Total amount</u>		
	<u>DISC</u>	<u>DESC</u>	<u>Total</u>	<u>DISC</u>	<u>DESC</u>	<u>Total</u>
	----- (millions) -----					
Under \$500	3,712	1,689	5,401	\$0.6	\$ 0.3	\$ 1.0
\$500 to \$5,000	1,385	761	2,146	1.8	1.2	3.0
Over \$5,000	<u>205</u>	<u>256</u>	<u>461</u>	<u>4.4</u>	<u>15.9</u>	<u>20.3</u>
Total	<u>5,302</u>	<u>2,706</u>	<u>8,008</u>	<u>\$6.8</u>	<u>\$17.4</u>	<u>\$24.3</u>

For the four hardware centers and the medical commodity as of September 30, 1982, reported overprocurements on purchase requests totaled about \$37.1 million. Overprocurements on purchase requests at the two centers visited accounted for 65 percent of these. We randomly selected 50-item samples from the over \$5,000 group--50 for DISC and 50 for DESC--to test cancellation procedures and practices. We analyzed each item to determine what action had been taken on the potential overprocurement and whether it was appropriate. Our sample consisted of items with open purchase requests as of the September stratification. Over time, purchase requests become contracts and funds are obligated; therefore, our detailed review included items with open purchase requests and/or contracts.

Our review was conducted in accordance with generally accepted government auditing standards. Statistics cited in this report were derived from data retrieved from DLA's automated system which receives input from several external sources and internal subsystems. We considered it impractical to assess the reliability of data received from each of these sources. As an alternative, we interviewed the inventory managers to insure that we used the same data that DLA uses in managing its affairs.

The systems and procedures at the centers visited are followed by all DLA centers. We believe, therefore, that the problems identified in this report could occur at all centers and the savings to be realized from improved procedures would be significant.

DLA CAN IMPROVE ITS IDENTIFICATION AND
CANCELLATION OF EXCESS ON-ORDER MATERIAL

We examined 100 items that had reported excess on-order assets of \$3.5 million as of the centers' September 30, 1982, quarterly stratification. Forty-two of these items had reported excess material on order valued at \$1.7 million when we reviewed them in January 1983. We believe DISC and DESC could have canceled most of the excessive on-order material we identified had their procedures and practices for identifying and canceling unneeded on-order material been better. As a result of our inquiries, the centers did cancel about \$655,000 of unneeded on-order assets.

Causes of overprocurements

Forty-five of the 100 sample items were erroneously reported in overprocurement status as of September 30, 1982, for various legitimate reasons. Items were erroneously reported in overprocurement status mainly because valid known requirements were for some reason excluded from the requirements computation and different criteria for asset application in stratification decisions and supply control decisions resulted in different supply positions. Additionally, some items were purposely overordered because of center policy and, therefore, the on-order material was not considered excessive. For example, 18 of the DESC items were classified as Diminishing Manufacturing Sources. This means the sole source supplier of the item has decided not to produce it anymore and, therefore, if it is needed, DESC has one last chance to make a lifetime buyout of the item. Since the procurement action might represent 10 or more years of stock, the computer categorizes this type of item as overprocured.

For the 55 items accurately reported overprocured as of September 30, 1982, the excess on order totaled about \$2.1 million. The following table shows why the on-order assets for these items became excessive.

	DESC		DISC		Total	
	<u>No. of items</u>	<u>Dollar value</u>	<u>No. of items</u>	<u>Dollar value</u>	<u>No. of items</u>	<u>Dollar value</u>
	(millions)		(millions)		(millions)	
Demand decreased after buy	10	\$0.816	15	\$0.574	25	\$1.390
Item manager overbought on purpose and/or in error	6	.271	9	.174	15	.445
Logistics reassignment problem	5	.099	2	.013	7	.112
Reduced procurement cycle due to standard price increase	-	-	5	.047	5	.047
Other	<u>2</u>	<u>.019</u>	<u>1</u>	<u>.039</u>	<u>3</u>	<u>.058</u>
Total	<u>23</u>	<u>\$1.205</u>	<u>32</u>	<u>\$0.847</u>	<u>55</u>	<u>\$2.052</u>

Centers need better internal controls to monitor item manager performance

The Industrial and Electronics Centers were not effectively identifying and canceling excess on-order material. For 42 items in our sample, \$1.7 million of the planned purchases examined were excess as of January 1983. As a result of our inquiries, the centers canceled \$654,880 of this material. We believe most of the excess could have been canceled had management established internal controls to insure that item managers effectively respond to cancellation notices.

Eleven items, erroneously reported overprocured on September 30, 1982, had excessive planned purchases of about \$275,000 as of January 1983. Also, 31 items accurately reported as overprocured on September 30, 1982, were still so as of January 1983, in the amount of \$1.418 million. After analyzing each item to find out how it got into the excess on-order condition and to see if anything had been done to correct the situation, we referred the items to center officials for evaluation and cancellation action. The following table shows the centers' actions.

Overprocurement and Cancellations

	<u>Overprocured</u>		<u>Cancellation</u>	<u>No</u>
	<u>No. of</u>	<u>Dollar</u>	<u>action</u>	<u>cancellation</u>
	<u>items</u>	<u>value</u>		<u>action</u>
			----- (millions) -----	
DESC	22	\$1.170	\$0.356	\$0.814
DISC	<u>20</u>	<u>.522</u>	<u>a/ .299</u>	<u>.230</u>
Total	<u>42</u>	<u>\$1.692</u>	<u>\$0.655</u>	<u>\$1.044</u>

a/Eventual cancellations totaled about \$7,100 more than originally computed; therefore, figures will not reconcile throughout table.

The fact that the centers could not or would not cancel \$1.044 million of the potential overprocurements does not imply that we agree with their position. For example, regarding 10 items with excessive on-order assets of \$526,000, DESC officials informed us that they could not do anything as the procurement status had changed to the contract stage and, therefore, it was too late to cancel the overprocurement. The fact that a procurement is on contract does not necessarily mean that cancellation cannot be attempted. One item, a circuit breaker (Stock No. 5925-00-407-4709), was reportedly overprocured by 81 units on purchase request, or \$192,400, as of September 30, 1982. As of January 20, 1983, 215 of 257 undelivered units on contract were excess in the amount of \$563,200. We called this potential overprocurement to DESC's attention on February 9, 1983. DESC officials initially did not try to cancel or reduce the buy because of past supply problems with the item. By March 17, 1983, only 176 undelivered units were still on contract. On March 30, 1983, after reconsidering the information we provided, DESC officials agreed that all 176 units were excessive, but by this time, only 81 undelivered units were still on contract. If DESC is successful in canceling the 81 units, it will save \$192,400; however, if it had been more aggressive, an additional \$370,800 may have been saved.

We reviewed the 31 items that had excessive on-order assets as of September 1982, and January 1983, to find out why the excesses had not been canceled. The following table shows why the items were still overprocured as of January 1983.

Reasons Excess On Order Not Canceled

	<u>DESC</u>		<u>DISC</u>		<u>Total</u>	
	<u>No. of items</u>	<u>Dollar value</u>	<u>No. of items</u>	<u>Dollar value</u>	<u>No. of items</u>	<u>Dollar value</u>
	(Dollar values in millions)					
Item manager took no action	12	\$0.892	11	\$0.360	23	\$1.252
Cancellation action incomplete or unsuccessful	-	-	5	.108	5	.108
Logistics reassignment dues-in ignored	<u>3</u>	<u>.058</u>	<u>-</u>	<u>-</u>	<u>3</u>	<u>.058</u>
Total	<u>15</u>	<u>\$0.950</u>	<u>16</u>	<u>\$0.468</u>	<u>31</u>	<u>\$1.418</u>

The fact that logistics reassignment dues-in were ignored in cancellation decisions is significant, not by the magnitude of their incidence but, as discussed later, because it indicates a systemic problem that distorts the supply position of an item and, therefore, the need for cancellation action.

The following are examples of conditions we found.

--On May 5, 1982, the computer recommended that DISC buy 130 units of a retaining plug (Stock No. 5340-00-257-6743). This was based on projected demands of nine units per quarter and a procurement cycle of 36 months. During the September 30, 1982, stratification, a new higher standard price was established and the recommended buy was reduced by 87 plugs. In reviewing this recommendation, the item manager noted the fact that there had been a recent change in the item's stock status and that demand had decreased. The item manager did not consider how decreased demand and change in unit price affected the procurement cycle and, therefore, the decrease in total requirements. We recomputed the requirement and determined that, as of January 21, 1983, the buy could be reduced by 92 units. As a result of our February 1983 inquiry, the item manager reduced the buy by 80 units and saved \$27,934.

--On July 14, 1982, the computer recommended that DISC buy 22 pounds of rivets (Stock No. 5320-00-929-9305), valued at \$186.34. The item manager modified the demand forecast resulting in a buy of 5,000 pounds of rivets at \$42,350. As of the September 30, 1982, stratification, the item was reportedly overprocured beyond the stockage objective by 4,461 pounds, or \$35,197. The item manager tried to cancel all 5,000 pounds on November 5, 1982. Apparently, the attempt was unsuccessful because as of March 6, 1983, the first significant deliveries were received. The amount being delivered based on current demand represents an unnecessary inventory investment of about 15 years of supply beyond required levels.

SAMMS has been designed so that item managers can, to the extent appropriate, rely on it to make decisions. Various supply control studies are generated by the computer which require some type of action by the item manager. For example:

--A buy study notifies the manager that assets are needed and, therefore, that a buy needs to be made.

--A cancellation notice alerts the manager when assets on hand and due in are excessive.

Each center has established review levels for approving procurement/cancellation actions based on certain dollar limitations. The item manager may totally approve, totally disapprove, or adjust the quantity on a buy or cancellation notice, but the action must be approved by the appropriate review level. However, if the item manager doesn't respond to a cancellation notice, this action is not reviewed by higher level management. This lack of action by item managers was the major reason that potential overprocurements were not canceled.

DESC and DISC officials agreed that they did not have effective internal controls to insure that cancellation notices were effectively responded to by the item manager. We believe most of the excessive planned procurements we identified could have been canceled had the centers required supervisors to periodically review cancellation and noncancellation actions and item managers' justifications for them.

System due-in review level criterion
needs to be modified

Centers are not effectively considering on-order assets from logistics reassignments in computing the review (cancellation) level. Additionally, the criterion for computing the

cancellation level allows unreasonable amounts of stock (buffer levels) to be included and, therefore, the potential amounts eligible for cancellation may be understated.

DLA knows that it has had problems with the way centers have treated existing dues-in from losing inventory managers during logistics reassignments. These problems became even more evident during the recent transfer of consumable item management to DLA. DLA thought the problems we had found during our review had been corrected. In a June 1982 memorandum, issued before our review, DLA said:

"All types of dues-in from any losing inventory manager should be included in the supply control process."

In the same memorandum, DLA stated the problem it wished to correct.

"However, a review of recent supply control studies indicate [sic] that some program changes have occurred which deviate from the established policy. Specifically, assets are not being applied properly and buys are being generated where logistics gain dues-in are adequate."

Fifteen of the 100 items we reviewed were recently assigned to DLA for management. Centers still were not adequately considering logistics gain dues-in when computing procurement and/or cancellation levels.

In the procurement process, SAMMS considers losing inventory manager contract dues-in as valid but ignores their purchase request dues-in. In contrast, when computing system due-in review levels, which notify item managers of potentially unneeded on-order material, SAMMS totally excludes logistics gain dues-in. In some instances, these practices contributed to reported and/or actual excess on-order conditions and precluded item managers from being notified of potential overprocurements.

The following examples illustrate the conditions we found at the centers.

--On July 7, 1982, a DISC item manager initiated a buy for 25 eccentric arms (Stock No. 1680-00-152-4419), valued at \$8,057. At that time, 150 units were due in on a Navy purchase request. There were no cancellation notices on this item since the purchase request was excluded from the SAMMS' computation of the system due-in review (cancellation) level. The item eventually was reported as

being overprocured during the September 30, 1982, stratification. (DLA's quarterly stratification considers all logistics gains as valid dues-in, and they are applied against requirements before center-generated dues-in).

--On September 4, 1982, DESC's computer recommended the center buy one piston cylinder (Stock No. 1440-00-785-6311), valued at \$447. At this time, there were 30 units on hand and 29 due in on an Army contract. The item manager ignored the dues-in and increased the recommended buy to 21 units. The item was reported as overprocured in the September 30, 1982, stratification. A cancellation notice was sent to the item manager on January 5, 1983, recommending cancellation of all 21 units on the DESC purchase request because all 29 units on the Army contract had been delivered. As a result of our inquiry, DESC canceled the purchase request for 21 units and saved \$9,677.

In addition, DLA's criterion for computing cancellation levels is inadequate because it allows significant buffer stocks to accrue before the item manager is even notified of potentially excessive on-order assets. The criterion--stockage objective requirement plus percentage of procurement cycle (usually 50 percent)--is generous when one considers that procurement cycles for medium and high dollar value items range from a 3- to a 22-month supply. The criterion increases the potential for accumulating unreasonably high levels of on-hand and on-order stocks before cancellation action is attempted. Additional levels of inventory of up to an 11-month supply above system requirements are unnecessary, in our opinion.

This problem became even more apparent in our review of DISC managed items. DISC's current buffer levels (percentage procurement cycle period) are set at 50, 150, and 200 percent, depending on the item's Federal Supply Class. For example, Stock No. 3120-00-517-8932 is in Supply Class 3120, which has a 150-percent buffer. As of January 21, 1983, the stockage objective for this item was 96 units and the procurement cycle requirement was 72 units. The buffer level of 108 units (150 percent times 72) would have actually been greater than the requirements for the item. The item manager would not have received a cancellation notice until the on-hand and on-order quantity exceeded the cancellation level of 204 units.

We believe a cancellation level criterion that allows buffer levels greater than system requirements precludes timely and effective identification and cancellation of excess on-order

stocks. This contributes to unnecessary inventory investment and/or procurement costs by understating the potentially excessive on-order stock that may be eligible for cancellation. Additionally, we believe excluding logistic gains dues-in from the supply control process distorts resulting procurement and cancellation decisions and, therefore, can also contribute to unnecessary inventory investment and/or procurement costs.



SS
MANPOWER
RESERVE AFFAIRS
AND LOGISTICS

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

18 DEC 1983

Mr. Frank C. Conahan
Director
National Security and International
Affairs Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Conahan:

This is the Department of Defense response to General Accounting Office (GAO) Draft Report, "Defense Logistics Agency Could Better Identify and Cancel Unneeded On-Order Material," dated October 14, 1983 (GAO Code No. 943390-OSD Case No. 6370).

We concur in your findings and recommendations except for one error of fact which is identified in the enclosed detailed comments. We have discussed this with members of your staff and they have agreed to make the necessary correction.

The opportunity to comment on this Report in draft form is appreciated.

Sincerely,

Jerry L. ...
Principal ...
(Manpower, ...)

Enclosure
As stated

GAC note: Page references in this enclosure have been changed to correspond to those in the final report.

GAO DRAFT REPORT - DATED OCTOBER 14, 1983
(GAO CODE NO. 943390) - OSD CASE NO. 6370

"DEFENSE LOGISTICS AGENCY COULD BETTER IDENTIFY
AND CANCEL UNNEEDED ON-ORDER MATERIEL"

DoD POSITION

* * * * *

FINDING A: The Defense Logistics Agency (DLA) Can Improve Its Identification And Cancellations Of Excess On-Order Material. Of the sample of 100 items taken as of September 30, 1983 (from 461 DISC and DESC items having more than \$5000 overprocurement), GAO found 45 of these items to be erroneously reported in overprocurement status for various legitimate reasons. For the 55 items accurately reported as overprocured, GAO found the excess on order to be about \$2.1 million. GAO further found that 31 items accurately reported as overprocured (in the September 30, 1982 sample) were still overprocured as of January 1983 in the amount of \$1.418 million. And, of those 45 items erroneously reported in overprocurement status from the original sample (September 30, 1982), GAO found that as of January 1983, 11 items had excessive planned purchases of about \$275,000. Noting the systems and procedures at the centers visited are followed by all DLA Centers, GAO concluded therefore that the problems identified could occur at all Centers and that the savings to be realized from improved procedures would be significant. GAO referred the 42 items (31 + 11 = 42) to Center officials for evaluation and cancellation, and noted about \$655,000 in cancellations. GAO further noted, however, that the Centers could not or would not cancel \$1.044 million of potential overprocurements. GAO stated the fact that the Centers would not cancel the other potential overprocurements does not imply GAO agreement with the Centers' position. In fact, GAO concluded that because the procurement is on a contract does not necessarily mean that cancellation can't be attempted. (pp. 7-9 of GAO Draft Report)

DoD Position: DoD concurs. It should be noted that a decision not to cancel all identified potential overprocurement is a matter of personal judgment on the part of the reviewing individuals. Each manager must make a judgment related to the quantities of materiel expected to be needed in future months. The administrative and possible termination costs associated with cancelling contractual quantities can result in a non-productive action when:

1. There is high probability that potential overprocured quantities will be utilized during a future period;
2. The availability of such quantities will negate the need for procurement funds during a future period; and
3. Cancellation of contractual quantities would cause a repetitive purchase action in the ensuing months

Cancellation should be attempted when the three conditions outlined do not exist.

FINDING B: Centers Need Better Internal Controls To Monitor Item Manager Performance. GAO reviewed the 31 items that had excessive on-order assets as of September 1982 and January 1983 to determine why the excesses had not been cancelled. GAO found that the continuing excesses were caused by (1) the Item Manager took no action—23 items, (2) the cancellation actions were incomplete or unsuccessful—5 items, and (3) the logistics reassignment due-ins were ignored—3 items. GAO noted that DLA's Standard Automated Materiel Management System (SAMMS) generates a cancellation notice to alert the Item Manager when assets on-hand and due-in are excessive. While each Center has established review levels for approving Item Manager cancellation actions, GAO found that if the Item Manager does not respond to a cancellation, this lack of action is not reviewed by higher level management. GAO further found that this lack of action by Item Managers was the major reason that potential overprocurements were not cancelled. GAO noted that officials agreed they did not have effective internal controls to ensure that cancellation notices were effectively responded to by the Item Managers. GAO concluded that most of the excessive planned procurements it identified could have been cancelled had the Centers required supervisors periodically to review cancellation and non-cancellation actions and the Item Managers' justification for them. (pp. 8-11 GAO Draft Report)

DoD Position: DoD concurs.

FINDING C: System Due-Ins Review Level Needs to be Modified. GAO noted that DLA recognized that it has had problems with the way Centers have treated existing due-ins from losing Item Managers during reassignment, but thought the problems found in the GAO review had been corrected. GAO found, however, that SAMMS treats due-ins from losing Inventory Managers as if they were customer returns. GAO further found that, in the procurement process, SAMMS considers losing Inventory Manager contract due-ins as valid but ignores their purchase request due-ins. In contrast, when computing system due-in review levels, which notify Item Managers of potentially unneeded on-order material, GAO found SAMMS totally excluded logistics gains due-ins. GAO concluded that excluding logistics gains due-ins from the supply control process distorts resulting procurement and cancellation decisions and, therefore, can also contribute to unnecessary inventory investment and/or procurement costs. (pp. 11-13 GAO Draft Report)

DoD Position: DoD concurs except for the statement that "...SAMMS treats due-ins from losing Inventory Managers as if they were customer returns". In the meeting with GAO representatives on 7 November 1983 it was agreed that the statement would be deleted from the final report since it is inaccurate.

FINDING D: The Criterion Used By DLA Managers To Determine Cancellation Levels Allows Stockage of Inventories Above System Requirements (Buffer Stocks) At Unreasonable High Levels. GAO found the criterion used by DLA manager to determine cancellation levels (i.e., stockage objective requirement plus percentage of procurement cycle (usually 50 percent)), to be generous considering that procurement cycles for medium and high dollar value items range from a 3- to a 22-month supply. GAO concluded that DLA's criteria for cancellation levels are inadequate because they allow significant buffer stocks to accrue before the Item Manager is even notified of potentially excessive on-order assets. GAO further concluded that additional levels of

inventory of up to an 11-month supply above system requirements are unnecessary. GAO finally concluded that a cancellation level criterion that allows buffer levels greater than system requirements precludes timely and effective identification of excess on-order stocks. (pp. 13 and 14 GAO Draft Report)

DoD Position: DoD concurs. The criterion used to determine "buffer stocks" for high dollar value items with a 3-6 month procurement cycle is not overly generous since it represents only a 1½ to 3 month supply. Approximately 50% of potential overprocurement identified in Finding A involves these items. The use of a variable buffer level for longer procurement cycle items is appropriate. (See response to Recommendation 2.)

RECOMMENDATIONS

RECOMMENDATION 1. GAO recommended that the Director, Defense Logistics Agency (DLA), direct the Centers to establish controls for monitoring and evaluating Item Manager performance in cancelling unneeded on-order material. (As a minimum, GAO suggested that such controls should ensure that supervisors routinely review Item Manager decisions on cancellation notices.) (p. 2, GAO Draft Report)

DoD Position: DoD concurs. Control procedures should be established over the review of on order quantities identified as potentially unneeded. The DLA will initiate the following actions:

a. LONG TERM ACTION

(1) Develop and implement within DLA's Standard Automated Materiel Management System (SAMMS) a mechanized output control over items in a potentially overprocured status. Provision will be made for mechanized recording of action taken and automatic followup for non-response.

(2) Specifications for implementation will be included in the Agency's current effort to modernize and upgrade the Materiel Management System. Target Date for implementation is: December 1986.

b. CURRENT ACTION

(1) Develop a uniform hard copy report which records all Item Manager notifications of potentially overprocured items. This report will be provided to first line supervisory personnel for monitoring and recording Item Manager action and performance. Hard copy reports will be subject to second line supervisory review.

(2) Target Date for implementation of the Current Action is: February 1984.

C. Compliance with the planned actions will be subject to periodic Headquarters Staff Review during regularly scheduled Materiel Management Reviews.

RECOMMENDATION 2. GAO recommended that the Director, DLA revise the program for computing due-in review levels to

— consider all types of due-ins from procurement equally unless it has been absolutely determined that they are invalid; and

— limit the amount of buffer stocks included in the determination of cancellation levels. One way this can be done is to adjust the length of the procurement cycle percentage in relation to the length of the procurement cycle. (p. 2 GAO Draft Report)

DoD Position: DoD concurs. The program for computing due-in review levels and the criteria used for notification of potential cancellation quantities should be modified. The DLA will initiate the following actions:

a. Develop and implement revised specifications for inclusion in the SAMMS which will consider all dues-in in computing potential cancellation of on order quantities.

b. Expedite the implementation of an existing policy change which will modify the criteria used in determining cancellation notices. This change was previously documented and an improvement in the implementation schedule is appropriate. The revised criteria will permit use of a variable cancellation level depending upon the length of the procurement cycle. In addition, the criteria will consider a dollar value threshold below which it is not considered economical to cancel.

Target Date for implementation: March 1985. This Target Date considers available programming resources and existing program schedules.

Implementation of the planned actions will be subject to periodic Headquarters Staff review and evaluation during regularly scheduled Materiel Management Reviews.