United States General Accounting Office

GAO

Report to Congressional Requesters

March 1990

DEFENSE INVENTORY

Defense Logistics Agency's Excess Materiel on Order

GAO United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-238353

March 6, 1990

The Honorable John Glenn
Chairman, Committee on
Governmental Affairs
United States Senate

The Honorable Earl Hutto
Chairman, Subcommittee on
Readiness
Committee on Armed Services
House of Representatives

This report responds to your April 1, 1988, and March 17, 1988, requests that we conduct a series of internal control audits on the Department of Defense's (DOD) management of inventories. It discusses the status of Defense Logistics Agency's efforts to control excess materiel on order from DOD contractors.

As arranged, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to interested committees and other Members of Congress; the Secretary of Defense; the Secretaries of the Army, Navy, and Air Force; the Director, Defense Logistics Agency; and the Director, Office of Management and Budget. We will also make copies available to other parties upon request.

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Executive Summary

Purpose

The Defense Logistics Agency is responsible for providing effective and economical logistics support to U.S. military forces. Its inventory, excluding fuel, grew from $3.5 to $9.4 billion between fiscal years 1981 and 1988. At the end of fiscal year 1988, 37 percent, or $3.5 billion was excess to known requirements for peacetime operating and war reserve stocks. The Subcommittee on Readiness, House Committee on Armed Services, and the Senate Committee on Governmental Affairs asked GAO to determine the amount of potential excess stocks on order and evaluate the process used for terminating excess orders.

Background

To avoid buying unneeded supplies, the Defense Logistics Agency's computer system identifies items for possible termination that are on order but, based on current information, may no longer be needed. Such items are called "excess on-order" items. The Agency requires that when the computer identifies items that are potentially excess, item managers are to review the computer data and, if appropriate, direct the contracting officer to terminate the contract if no costs are involved. If termination costs are involved, the contracting officer is to obtain the amount of the costs from the contractor. Then item managers are to evaluate the costs and determine if terminating the contract or reducing the order is in the government's best interest.

Results in Brief

Based on GAO's random sample at three supply centers, GAO estimates that from a universe of $683.1 million the value of excess materiel on order for contracts over $5,000 was between $204 million and $449.1 million.

For most excess on-order items, item managers are not making termination recommendations to contracting officers. For example, at the Construction Supply Center contracts falling below $25,000 are not considered for termination. This relatively high threshold excluded 98.5 percent of the Center's contracts. Item managers are also incorrectly recomputing requirements or arbitrarily increasing requirements to avoid recommending terminations. GAO found that because of lax or nonexistent supervision, questionable decisions not to recommend terminations are not reversed.

Even when items are recommended for termination, contracts are not terminated if this would result in cost to the U.S. government. In these cases, item managers are making decisions to accept unneeded items without performing a required cost benefit analysis. Unless item managers receive estimates of termination costs, they do not have a reliable database to determine if acquisition of excess items is in the government's best interest.

Principal Findings

Item Managers Make Few Termination Recommendations

For the $204 million to $449.1 million excess on-order materiel at the three supply centers we reviewed, item managers requested terminations valued at only $49.9 million. GAO found that these supply centers purposely avoided making some additional terminations. For example, if the Construction Supply Center had adopted a $5,000 threshold similar to other supply centers, the center would have considered an additional 879 contracts valued at $8.5 million for termination.

GAO also found instances when item managers questioned requirements but recomputed requirements using incorrect data. In these cases, supervisors did not either review or change the item managers' decision. These cases resulted in a 1-year to 33-year oversupply of such items as solenoid valves, hospital gowns, women's dress shirts and utility trousers. Item managers also simply increased requirements to stop the computer from reporting items as being excess and on order. For example, the item manager increased requirements for fire retardant shirts to avoid computer identification of the item as excess. Consequently, the supply center purchased a 7-year supply of shirts valued at $8.7 million.

Contracts Not Terminated When Some Costs Are Involved

During the last half of fiscal year 1988, the six supply centers reported terminated contracts valued at $65.8 million, even though item managers requested that $253 million in excess materiel be terminated. The low termination rate is attributed in large part to the practice of not terminating contracts when costs are involved. Contracting officers are not providing information on estimated termination costs to item managers. For example, in May 1988, the aircraft yoke subassembly item manager recommended to the contracting officer that 586 subassemblies valued at $251,980 be terminated. The contracting officer took no action on this recommendation because (1) the contract administrator was negotiating a delivery extension and (2) the contractor would not accept a no-cost termination. However, another option existed. The contract probably could have been terminated without cost to the U.S. government because the contractor could not meet the delivery terms of the contract. The unneeded subassemblies represented almost a 10-year supply.

Neither the Department of Defense nor the Defense Logistics Agency has developed adequate guidance for item managers to follow when evaluating the economics of contract terminations. Item managers need to consider such factors as the amount of termination costs, the degree unneeded items exceed actual requirements, the cost of the items, and the storage cost for accepting unneeded items. Until item managers consider these factors in doing a cost benefit analysis, supply centers will continue to purchase items not in the government's best interest.

Recommendations

GAO recommends that the Secretary of Defense instruct the Director, Defense Logistics Agency, to

- require the development and implementation of a cost comparison methodology or model to assist supply center personnel in making cost-effective termination decisions, as required by the Department of Defense's policy;
- require contracting officers to determine termination costs so item managers can make cost benefit analyses;
- require that supervisors review item manager decisions concerning contract terminations;
- review locally implemented operating procedures that limit the dollar value of termination requests initiated by item managers; and
- continue to stress the importance of timely and accurate processing of potential excess on-order reports.

Agency Comments

The Department of Defense generally agreed with GAO's findings and recommendations, and noted planned or ongoing corrective actions to improve the management of excess materiel on order throughout the Department.

Contents

Abbreviations

DLA	Defense Logistics Agency
DOD	Department of Defense
GAO	General Accounting Office

Introduction

The primary responsibility of the Defense Logistics Agency (DLA) is to provide effective and economical logistics support, including procuring, stocking, and issuing supply items, to U.S. military forces. Excluding fuel, DLA manages about 2.9 million supply items and processes about 29 million requisitions annually for materiel valued at $6.4 billion. At the end of fiscal year 1988, DLA's on-hand inventory, excluding fuel, was valued at $9.4 billion. Thirty-seven percent, or $3.5 billion, was excess to known requirements for peacetime operating stocks and war reserve stocks.

Computer Identifies Possible Excess Materiel

DLA has two reports that address excess materiel on order. First, DLA's stratification report contains information on materiel on order that DLA has determined is excess to its requirements at the end of each quarter. Second, a monthly report (called a due-in report) shows the potential excess materiel due in to DLA depots for item managers to review to determine the amount that should be recommended for termination.

At the beginning of fiscal year 1984, DLA's stratification report showed that supply centers had $289 million of excess materiel on order. By the end of fiscal year 1988, that amount had increased to over $471 million, as shown in table 1.1. This represented about.9 percent of the total value of assets DLA had on order at the end of fiscal year 1988.

Table 1.1: Value of Excess Materiel on Order for Fiscal Years 1984-1988

Dollars in thousands

DLA supply center	1984	1985	1986	1987	1988
Construction	$29,587	$36,642	$58,608	$34,822	$29,219
Electronics	48,041	99,991	110,359	81,649	58,482
General	23,900	34,052	44,693	39,796	28,861
Industrial	45,635	72,500	89,274	82,012	76,570
Personnel-clothing & textile	150,267	170,984	199,210	163,000	247,017
Personnel-medical	21,834	22,334	31,562	56,059	31,028
Total	**$319,264**	**$436,503**	**$533,706**	**$457,338**	**$471,177**

Contrasted to the $471 million of excess materiel on order at the end of fiscal year 1988, DLA supply centers reported that the computer had identified potential excess materiel due in to DLA depots valued at $991.9 million, as shown in table 1.2. Each center established a minimum value of potential excess materiel on order by contract for the item managers to review for possible termination. When the value (threshold) was exceeded, the computer generated a due-in report for the item manager that identified possible excess materiel on order.

Table 1.2: Value of Potential Excess Materiel Due in to DLA Depots as of April 1988

Dollars in millions

	Amount
Construction	$147.2[a]
Electronics	119.4
General	129.3
Industrial	179.5
Personnel-clothing & textile	364.5
Personnel-medical	52.0
Total	**$991.9**

[a]Dollar value for the Construction Supply Center is for May 1988.

DLA item managers are required to review the computer due-in reports for their accuracy. In doing so item managers are to ensure that the reports are up-to-date and include all requirements and assets, both on hand and due in. Where appropriate, they are to recommend that the contracting officer terminate or reduce excess materiel on order if there are no termination costs.[1]

Item managers are also required to document reasons for not recommending contract terminations or reductions. They are required to send the termination requests to the responsible contracting officer, who then promptly determines what termination costs, if any, might be incurred. If none, the contracting officer should terminate the contract. If termination costs are involved, the contracting officer then should obtain from the contractor the amount of such costs and notify the item manager, who decides whether terminating the contract is in the government's best interest. If termination is appropriate, the item manager directs the contracting officer to terminate the contract.

DLA's Self-Assessment of Internal Controls

The Federal Managers' Financial Integrity Act of 1982 requires executive agencies to establish and maintain effective internal controls in line with the Comptroller General's Standards For Internal Controls In the Federal Government. The act requires heads of agencies to annually examine their internal controls using guidelines established by the

[1]DLA Manual 4140.2 and the practices and procedures of each supply center govern the item managers' review of the reports.

Office of Management and Budget to ensure that assets are safeguarded against waste, loss, or unauthorized use. Agencies then report whether their systems comply, and identify any internal control weaknesses and plans for corrective actions.

In March 1987, DLA headquarters asked the supply centers to include the excess on-order program in their fiscal year 1987 internal control program reviews. None of the centers identified any material weaknesses for the program in fiscal year 1987.

In fiscal year 1988, the Defense Personnel Support Center reported a material weakness: it sometimes awarded contracts for materiel that was needed at the time of the initial purchase, only to have requirements change before the contracts were finalized. The Center also indicated that management personnel lacked adequate oversight of actions taken by item managers in response to due-in reports of potential excess. These weaknesses were highlighted, in part, as a result of our current review.

The Center proposed two actions to strengthen internal controls: (1) increase management oversight and emphasis to reduce the dollar value of due-in reports and (2) develop a check within the computer system to prevent awarding contracts for excess materiel. Although the Construction Supply Center did not identify it as a material weakness, the internal control review concluded that the importance of accurately determining requirements needed to be reemphasized to item managers.

In commenting on a draft of this report, DOD said that its December 13, 1989, policy memorandum on contract termination of unneeded items emphasized the need to review high value contracts before award to confirm requirements. Corrective actions to the specific internal weaknesses identified at the Defense Personnel Support Center and the Defense Construction Supply Center will be implemented by March 15, 1990. DOD also said that DLA will include the excess on-order program in its 1990 statement of assurances on internal controls.

Prior Audit Reports

Several prior audits identified significant weaknesses in DOD and DLA policies and procedures for identifying and processing procurement terminations for excess materiel on order. In January 1984, we reported that DLA had failed to terminate orders for excess materiel because it had ineffective internal controls to monitor item managers' actions on computer-generated termination recommendations.[2]

In March 1985, we reported that the Navy's inventory control points had terminated less than 1 percent of the potential excess materiel on order identified by their computer systems.[3] The low number of terminations was partly related to the high dollar value thresholds and inadequate supervisory review and oversight. In May 1988, the DOD Inspector General found that these problems had not been corrected.[4]

In August 1987, we reported that the Air Force terminated less than 3 percent of the total value of excess on-order aircraft spare parts.[5] We recommended improvements in practices and procedures for analyzing the cost-effectiveness of procurement terminations for excess materiel on order.

According to the DOD Inspector General's March 1989 report, the Army terminated less than 3.1 percent of the potential excess materiel on order identified by the computer.[6] The Inspector General concluded that the value of completed termination actions was low due to the lack of management oversight. Also, the report stated that contracting officers often made uneconomical termination decisions because they lacked adequate guidance.

Objective, Scope, and Methodology

In March 1988, we testified before the Subcommittee on Readiness, House Committee on Armed Services, on DLA's recent inventory growth. As a result, the Subcommittee and the Senate Committee on Governmental Affairs asked us to evaluate DLA's program for managing excess on-order materiel. Our overall objective was to determine the amount of potential excess stocks on order and evaluate the process used for terminating excess orders. We also evaluated the effectiveness of DLA's policies and procedures to identify orders for excess materiel. Using the

[2] Defense Logistics Agency Could Better Identify and Cancel Unneeded On-Order Material (GAO/NSIAD-84-42, Jan. 10, 1984).

[3] The Navy Can Increase Cancellations of Procurements for Unneeded Material (GAO/NSIAD-85-55, Mar. 22, 1985).

[4] Contract Terminations at the Navy Aviation Supply Office (DOD-IG-88-153, May 23, 1988).

[5] Air Force Should Terminate More Contracts for On-Order Excess Spare Parts (GAO/NSIAD-87-141, Aug. 12, 1987).

[6] Contract Terminations at Army Inventory Control Points (DOD-IG-89-063, Mar. 29, 1989).

dollar value of computer-identified potential excess materiel on order, we determined whether DLA's policies and procedures were adequate to ensure that, when appropriate, item managers recommended terminating excess orders in a timely manner.

We performed our work at DLA headquarters in Cameron Station, Virginia, and three of its six supply centers—Defense Construction Supply Center, Columbus, Ohio; Defense Electronics Supply Center, Dayton, Ohio; and the Defense Personnel Support Center, Philadelphia, Pennsylvania. At the Personnel Support Center, we did not review subsistence commodities since item managers do not control inventory through the Standard Automated Materiel Management System. We reviewed management policies and procedures specified by DLA's Supply Operations Manual and local rules and regulations. Collectively, the three centers had 69 percent of DLA's potential excess materiel on order as of April 1988.

We used the same computer programs, reports, records, and statistical reports that DLA uses to manage inventories, determine requirements, and make termination decisions. We did not independently verify the specific computer-generated requirements data.

To evaluate the accuracy of DLA's mechanized procedures for identifying and reporting excess materiel on order, we developed a universe of potential excess materiel on order at each of the three DLA supply centers we examined. We used April or May 1988 computer-generated summary reports of termination notices provided to item managers. We then stratified each universe into four subgroups based on dollar value and randomly sampled orders from within each subgroup.

For each sample item that was potentially overprocured, we compared available assets on hand and due in to the current forecast requirements. For those sample items where we found excess materiel on order, we estimated the value of the materiel by projecting the value of the overprocurements to the universe of potential overprocurements. Appendix I contains a more detailed description of our sample design and data analysis methodology.

We conducted our work from April 1988 to September 1989 in accordance with generally accepted government auditing standards.

Item Managers Should Recommend More Procurement Terminations

DLA has supply centers that manage, among other things, construction, electronics, clothing and textiles, and medical items. From our sample of potential excess materiel on order at three centers for April or May 1988, we project that the materiel is valued at between $204 million and $449 million. From this total, item managers requested that contracting officers terminate excess materiel valued at $49.9 million. Data were not available to determine how much was actually terminated.

Item managers did not recommend many potential terminations because they believed it could affect their abilities to fill customer requisitions, which is the main basis for their performance evaluations. In this case, either lax or nonexistent supervisory review in effect made the item managers' decisions final.

The supply centers have not adequately implemented DLA policy guidance for effective item manager review of the computer-generated excess on-order reports and supervisory review of item managers' actions. Moreover, DLA officials had not adequately followed up at the supply centers to ensure that DLA's policy had been implemented as directed.

Most Orders for Excess Materiel Are Not Recommended for Termination

Our random sample of potential excess materiel at DLA's Construction, Electronics, and Personnel Support[1] Supply Centers included only orders over $5,000 since the Centers do not consider orders less than that for termination. From a universe valued at $683.1 million, we estimate that $326.5 million, plus or minus $122.6 million, was actually excess materiel. However, item managers recommended only $49.9 million to contracting officers for termination. Therefore, item managers did not recommend terminations for excess materiel valued at $276.6, plus or minus $122.6 million. Because it appeared a great deal of excess materiel was on order, our sample was designed to show the general magnitude of the excess rather than a precise value, which would have required much more work. Table 2.1 shows the estimated value of excess materiel on order for the three supply centers and the value of recommended terminations.

[1]Our sample at the Personnel Support Center excluded subsistence items.

Table 2.1: Estimates of Actual Excess on Order and Recommended Terminations[a]

Dollars in millions

Supply center	Due-in report sampled[b]	Potential excess value	GAO estimate	Recommended terminations
Construction	May 6, 1988	$147.2	$76.6	$19.1
Electronics	April 5, 1988	119.4	49.8	24.3
Personnel-medical	April 8, 1988	52.0	13.9	6.5
Personnel-clothing & textiles	April 8, 1988	364.5	186.2	0.0
Total		**$683.1**	**$326.5**	**$49.9**

[a]Contains only contracts over $5,000.

[b]Based on September 1988 asset information since April 1988 due-in studies were not available.

Item Managers Are Reluctant to Recommend Terminations

Item managers sometimes avoided termination recommendations by recomputing requirements or by increasing requirements without any sound basis. In other instances, item managers cited supply center termination thresholds as the reason for their decisions. Such item manager decisions were final because supervisory oversight and disapproval of their actions were either lax or nonexistent. This situation resulted because the supply centers had not adequately implemented DLA policy guidance for effective item manager review of the computer-generated reports and supervisory review of item managers' actions concerning the reports. Moreover, DLA officials had not adequately followed up at the supply centers to verify that the policy had been implemented properly.

In commenting on a draft of our report, DOD agreed that accurate computer data are essential for the DLA supply system to function properly. To the extent that computer file corrections are not being made, or are not being made correctly, DOD agrees that corrective action is required. It also said that there are valid reasons for many items originally categorized as unneeded not being terminated. At the DLA supply centers some 40 percent of items reviewed for potential overprocurement do not become candidates for termination. According to DOD, the most common reason for this is adjustment of the file data due to revised requirements or inventory position information. We recognize that not all potential overprocured items should be recommended for termination and that inaccurate computer file data should be corrected to accurately show assets and requirements.

Requirements Recomputed but Excess Not Recommended for Termination

Even when item managers recomputed requirements, the materiel on order was sometimes still excess. We found a number of instances where item managers questioned requirements data, but did not recompute the requirements based on correct information. In these cases, supervisors either did not review or did not change the item managers' decisions. For example:

- The computer reported as potential excess 704 solenoid valves valued at $152,915 for howitzers and the M578 recovery vehicle. The item manager recomputed the requirement and found that 471 valves valued at $110,670 were on order but not needed. However, the item manager did not recommend termination to the contracting officer. She believed that demand was understated due to a large quantity of backorders, and that the lead time figures were understated. Using the Center's requirements data, we found that 555 of the valves on order were not needed. The unneeded valves are valued at $130,408 and represented an almost 2-year supply.
- The computer reported as potential excess 40,729 hospital gowns valued at $206,000. The item manager concluded that the excess on order resulted from his anticipation of demands that never materialized. Further, he believed terminating current excess materiel on order could lead to a future shortage. Using the Center's requirements data, we found that the item manager should have recommended terminating the contract for 33,120 gowns valued at $168,000. The unneeded gowns represented more than a 1-year supply.
- In April 1988, the computer reported as potential excess an order for 4,186 size 12L x 24-1/2 Army women's long sleeve dress shirts valued at $32,357—one of 118 different sizes of this shirt. The excess occurred because the Army recently doubled the number of stocked sizes, and demand had not materialized as planned, according to Personnel Support Center officials. In evaluating the Army's request to stock the additional sizes, Center officials argued that stocking 118 different sizes would lead to significantly increased costs and future excesses. The item manager did not recommend that the contracting officer terminate the order because she was managing the shirt by total requirements rather than by shirt size (i.e., she had shortages in other sizes). According to Center officials, they planned to issue a contract modification in March 1989 to increase on-order quantities for sizes in short supply and eliminate some of the excess on-order quantities. As of September 1988, the Center had 6,348 unneeded size 12L x 24-1/2 shirts on order, or almost a 33-year supply. In August 1989, the Center issued a contract modification to reduce size 12L x 24-1/2 shirts by 368.

- In April 1988, the computer reported that all 23 sizes of utility trousers had excess on order, including 113,166 pairs of size 33R utility trousers valued at about $1.2 million. The item manager did not terminate the contract for the trousers because they had been ordered from a supplier to replace deliveries from a previous supplier who was under criminal investigation. To avoid future potential excess reports, the item manager increased the procurement cycle requirement from 6 to 36 months. However, the first supplier was cleared in December 1987; therefore, the item manager should have recommended terminating the order. In January 1989, the Center had 828,000 unneeded trousers on order valued at almost $8.5 million, or a 3.2-year supply.

Requirements Increased to Prevent Future Potential Excess Reports

Accurate computer data are essential for the DLA supply system to function properly. The supply centers' computers generate monthly due-in reports, which identify items with potential excess over $5,000 for item manager review. However, for items in our sample that were not recommended for termination, item managers sometimes increased requirements so the computer would not identify certain items as being on order and overstocked. For example:

- In May 1988, the computer reported potential excess orders for aircraft refueling hoses used on ships. In February 1988, the item manager doubled the quarterly demand forecast from 357 to 714 to prevent future potential excess reports, but the computer generated another report in May 1988. This time the item manager doubled the procurement cycle from 3 to 6 months. According to the item manager, he wanted to avoid the reports because (1) existing stock was unserviceable or of questionable quality and (2) delivery of stock due in on one contract was questionable because the contractor had declared bankruptcy. At our request, the item manager recalculated the requirements using the correct quarterly demand and procurement cycle, but excluded on-hand unserviceable materiel and materiel due in from the bankrupt contractor. The item manager concluded that 1,756 items due in were excess to requirements. The 1,756 unneeded items represented a 15.5-month supply valued at $554,263.
- In April 1988, the computer reported potential excess orders for 1.4 million fire retardant utility shirts. All nine sizes of this shirt had excess orders. The cost per shirt is $8.39. Rather than recommending termination of the contract, the item manager increased the requirements from a 6-month to a 5-year supply. The item manager said she made the change to avoid having the contracts appear on future potential excess reports. As a result of our inquiries, Personnel Support Center officials

agreed to reconsider her decision. The administrative contracting officer later said the Center had investigated terminating the contract; however, the estimated termination costs were $600,000, which Center officials considered uneconomical. In January 1989, DLA had 379,000 shirts on hand and 1,078,000 on order to meet a requirement for 424,000 shirts. The unneeded shirts represented almost a 7-year supply valued at $8.7 million.

- In April 1988, the computer reported a potential excess order for 868 size 46R Coast Guard coats. The item manager determined that the excess on-order quantity occurred because the original order was based on an anticipated 62-percent increase in Coast Guard staffing levels. The increase, however, was not approved. To avoid having these orders appear on future potential excess reports, the item manager increased requirements from a 12-month to a 36-month supply. As of September 4, 1988, DLA had 665 unneeded coats on hand, plus an additional 55 due in. The 720 unneeded coats represented a 12-year supply valued at $61,324.

Supply Center Thresholds Reduce the Number of Termination Recommendations

DLA allowed each center to establish its own termination policies. Therefore, to limit item managers' reviews, centers have programmed their computers to report an item as potential excess only when it exceeded certain limits. For example, the Electronics Supply Center's computer identified an item as potential excess only when its value exceeded $5,000. According to DLA officials, the centers did not have sufficient resources to review all potential excess. Each center also established its own criteria, including the contract values for which it will attempt termination. The objective is to focus termination decisions on high value orders.

On June 30, 1988, DLA asked its supply centers to provide detailed information on their termination policies. The Construction Supply Center reported that it only pursued terminations if the value of the contract exceeded $25,000 and the value of the excess materiel exceeded $10,000. This policy was established even though (1) 98.5 percent of the Center's procurement awards were $25,000 or less and (2) the Federal Acquisition Regulation states that contracting officers should try to terminate contracts for excess materiel on order unless the remaining work is under $2,000. As a result, many potential terminations were not considered.

According to the Center's policy, contracts cannot be terminated if more than half the production lead time has passed, and the entire quantity must be terminated for delinquent contracts. The other centers reported considering terminations if the remaining work was more than $1,000 and $250.

According to the Construction Supply Center's records, item managers use the termination policies as the basis for not recommending procurement terminations of a significant amount of excess materiel on order. For example:

- The Center did not try to terminate 172 unneeded light armored vehicle adjuster linkages valued at $5,500. The computer reported them as potential excess in May 1988. The item manager did not recommend termination because the contract value was under $25,000. The 172 unneeded items represented a 7-year supply.
- In May 1988, the Center did not try to terminate an order for 27 aircraft linear actuator pistons because more than half of the production lead time had passed. The item manager's decision complied with the Center's policy. However, the pistons valued at $50,000 may not be needed for many years, if ever. The demand for this item is low and the item manager's requirements showed that only three pistons were needed. As of May 1988, the Center had 198 pistons on hand and 27 on order. The 225 unneeded pistons represented a 74-year supply.
- The Center had seven Trident submarine solenoid valves valued at $71,427 due in under a contract that was delinquent because the contractor failed to meet the delivery date. As of May 1988, only three of the on-order valves were needed. The item manager did not recommend terminating the order for the four excess valves because he could not recommend a partial reduction to a delinquent contract. The four unneeded valves represented a 2-year supply.

Our analysis of the Construction Supply Center's May 1988 excess on-order summary report shows that $27.3 million of the Center's $147.2 million potential excess on order was not considered for termination because of the Center's termination policy. Table 2.2 shows the contracts not recommended for termination.

Table 2.2: Construction Supply Center Contracts Not Recommended for Termination

Policy	Number of items	Value (millions)
Contract not over $25,000	879	$8.5
Contract change not over $10,000	427	4.1
Over 50 percent of production lead time has passed	179	8.2
Delinquent contract[a]	336	6.5
Total	**1,821**	**$27.3**

[a]A contract is delinquent when the contractor fails to comply with contract terms (e.g., fails to deliver materiel by the required date).

Conclusions

Item managers for most excess on-order items are unnecessarily avoiding making termination recommendations to contracting officers. At the Construction Supply Center, contracts falling below $25,000 are not considered for termination. This relatively high threshold excluded 98.5 percent of the Center's contracts. Item managers are also incorrectly recomputing requirements or arbitrarily increasing requirements to avoid recommending termination. We found that because of lax or nonexistent supervision, questionable decisions not to recommend terminations are not reversed.

Recommendations

We recommend that the Secretary of Defense instruct the Director, DLA, to

- require that supervisors review item managers' decisions concerning terminations and
- review and approve locally implemented operating procedures that limit the dollar value of termination requests initiated by item managers.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD generally agreed with our findings and recommendations. DOD agreed that improvements are needed in supervisory reviews of termination decisions and item manager actions on termination recommendations. DOD stated that DLA will issue guidance emphasizing the importance of supervisory reviews and monitoring of excess on-order actions. DLA will also take action to incorporate the review of excess on-order actions into its internal control program. Additionally, DLA will advise its supply centers that a timely and effective supervisory review for both termination and non-termination decisions, and processing of actual termination actions will be enforced.

Reportable tracking mechanisms will also be implemented to monitor progress.

DOD stated that DLA has initiated a study to develop and design a decision model to better define when it is cost-effective to terminate a contract. The decision model will be utilized by both the inventory managers and contracting officers to assist the termination decision-making process. DOD believes this will eliminate the need for locally developed threshold values and accompanying procedures. The model is scheduled to be deployed at the DLA supply centers by June 30, 1990.

Contracts for Excess Materiel Were Not Terminated When Termination Costs Were Involved

Supply center contracting officers were not terminating contracts for excess materiel when there were termination costs. When contractors do not accept a no-cost termination, contracting officers are to determine the costs. Item managers should determine if terminating the contract is in the government's best interest.

According to the Federal Acquisition Regulation, contracting officers should terminate orders for materiel that is no longer needed, when it is in the government's best interest. Several options are available: terminating for the government's convenience at no cost, terminating for the government's convenience with termination costs, and terminating for default when the contractor has not complied with contract terms. Also, the Federal Acquisition Regulation states that contracting officers should try to terminate the contract unless the remaining work is under $2,000.

The Federal Acquisition Regulation recognizes the government's obligation in such terminations to reimburse contractors for costs incurred and provides guidelines on how much the contractor should receive for attempting to fulfill the contract. However, neither DOD nor DLA has established adequate guidance for item managers to follow when evaluating the economics of contract terminations. As a result, contracts were not terminated when costs were involved.

Potential for More Contract Terminations

During the last half of fiscal year 1988, DLA supply centers reported terminating contracts valued at $65.8 million, even though item managers had requested that $253 million of contracts for excess materiel be terminated. Moreover, during the fiscal year, the supply centers we reviewed paid little or no termination costs. For example, the Electronics and Construction Supply Centers each paid less than $30,000 in contract termination costs while the Personnel Support Center had no record of any such payments.

The failure of DLA supply centers to complete timely and cost-effective procurement terminations, especially when termination costs were involved, resulted in DLA receiving, storing, and paying for items that were not needed to meet its requirements. For example:

- In May 1988, the computer reported a potential excess order for 727 aircraft yoke subassemblies valued at $372,000. The item manager reviewed the requirements for the subassemblies, and on May 17, 1988, requested terminating 586 valued at $251,980. Over 3 months later, the contract specialist told the item manager the contract could not be terminated because (1) the contract administrator was negotiating a delivery extension and (2) the contractor would not accept a no-cost termination. Since the negotiations had encouraged the contractor to continue the contract, the government had no right to terminate it, according to Center officials, and termination costs would have been 70 percent of the contract price. We found that the contracting officer took no action to terminate the contract until after we inquired about it in August. Moreover, if action had been taken in response to the item manager's request in May, the Center could have possibly charged the contractor with default since it failed to meet the required delivery date. As of May 1988, the 586 unneeded subassemblies represented almost a 10-year supply.

- In April 1988, the computer reported a potential excess order for 522 catheter and needle packages valued at $22,000. During March, the item manager had requested a no-cost termination for 580 packages, and then initiated a follow-up request in April. On April 26, 1988, the item manager learned from the contracting officer that termination costs were involved and that the contractor said that shipment was imminent. However, although the required delivery date was May 2, 1988, as of July 1, 1988, the contractor had not delivered the items and was therefore in default. The contracting officer could have terminated the contract at no cost to the government. The 522 unneeded items represented a 2-year supply.
- In April 1988, the computer reported a potential excess order for 162 rib cutting shears valued at $42,000. During March, the item manager had requested terminating an order for 150 shears. The contracting officer advised the item manager on April 27, 1988, that the contractor would not accept a no-cost termination and the shipment was eminent. Therefore, the contracting officer made no attempt to determine the termination costs. The 162 unneeded items represented about a 4-year supply.

When contractors rejected a no-cost termination, contracting officers should have determined the termination costs, and the item manager should have performed a cost benefit analysis to evaluate whether terminating the contract was in the government's best interest. However, contracting officers normally did not determine termination costs. The cost benefit analysis would have enabled the item manager to compare termination costs to the value of the unneeded stock and storage costs. When appropriate, contracting officers should have tried to negotiate termination costs with contractors, but no DOD policy currently requires this.

Each Supply Center Has Its Own Termination Policy

Each supply center has developed its own policies regarding termination costs. In December 1986, the Construction Supply Center requested policy guidance from DLA for terminating contracts for excess on-order materiel. DLA stated that contracts that are within 90 days of delivery or are for less than $10,000 are poor candidates for termination because of contractor-incurred costs and the small contract amount. It also said that when termination costs are substantial, further action should not be pursued; however, if costs are nominal, the action should continue. In November 1987, the Center established its own policies, including a guideline to avoid terminating contracts valued at less than $25,000.

Other DLA centers have issued different termination policies. In June 1988, the Personnel Support Center's Medical Directorate established a policy that allows for termination costs up to 20 percent of the contract value. In April 1988, the General Supply Center established a policy that allows termination costs up to 50 percent of the contract value for those contracts valued at $25,000 or less. Contracts over $25,000 are evaluated on a case-by-case basis.

In commenting on a draft of our report, DOD agreed that there are variations between DLA supply centers' termination policies. It said that such management flexibility was appropriate in view of the centers' variation in work load, personnel resources, and the nature of the commodities managed. DLA will issue guidance on contract termination policy and reviews to its supply centers.

Termination Requests Could Be Processed in a Timely Manner

Prompt processing of recommendations to terminate contracts is essential to avoid continued contractor costs for excess materiel. We found most requests took over 60 days to be processed. For example, at the Personnel Support Center's Medical Directorate, from May to July 1988, item managers sent 45 requests to the buying branch to terminate excess orders valued at $873,000. As of November 1988, contracting officers had not attempted terminations for 14 of these requests, which were valued at $222,000.

The Construction Supply Center has a computerized database of item managers' termination recommendations. Of the 345 recommendations valued at $5.7 million for May through September 1988, 281 or 81 percent required over 60 days to complete. The longest time required was 155 days, and only 7 percent were processed within 30 days.

In commenting on a draft of our report, DOD agreed that prompt processing of recommendations to terminate unneeded items is essential to avoid continued contractor costs for such items. Accordingly, DLA believes that time parameters can be established for processing terminations and included in its termination model.

Continued Weaknesses in Internal Controls

In January 1984, we reported that DLA needed to establish internal controls, including effective supervisory reviews to ensure that item managers take appropriate actions to avoid purchasing unneeded items identified by the computer as on order and not yet delivered. DLA established internal controls that, in part, required effective supervisory reviews. In the supply centers we reviewed, the supervisory reviews were still inadequate.

We found inadequate supervisory reviews of item managers' decisions to terminate or not to terminate excess materiel on order at both the Construction and the Electronics Supply Centers. At the Construction Supply Center, 18 of the 66 cases (27 percent) that had May 1988 potential excess materiel on-order reports did not have the required supervisory review. At the Electronics Supply Center, 16 of the 41 cases (39 percent) with April 1988 reports did not have the required supervisory review. The Personnel Support Center had not established a policy that required supervisors to document their review of completed item manager actions.

In commenting on a draft of our report, DOD agreed that supervisory review was inadequate and said that DLA will issue guidance to its supply centers emphasizing the requirement for adequate supervisory review of item manager decisions on contract terminations.

Additionally, the computer's potential excess on-order reports were not always reviewed by the item managers as required. Both the Construction and Electronics Supply Centers had two of these cases in our sample. For example:

- At the Electronics Supply Center, the computer reported as potential excess 390 electrical connector plugs valued at $35,813. The item manager did not evaluate the computer report. The 390 on-order items represented a 4.3-month supply. Later, on September 19, 1988, as demand continued to drop, the item manager recommended the contracting officer terminate 1,629 due-in plugs valued at $149,591. On October 31, 1988, the contract specialist determined that the order could not be terminated because the contractor planned to complete shipment within the next month. As of November 1988, the Center had more than a 4-year supply.

- At the Construction Supply Center, the computer reported as potential excess 124 aircraft matched gear sets valued at $50,392. The item manager position was vacant and no one reviewed the computer report or recommended that the contracting officer terminate the unneeded materiel. The Center had a requirement for 259 gear sets, but had 284 on hand. The 25 unneeded items on hand plus the 124 on-order sets represented over a 1-year supply.

In our January 1984 report, we recommended that DLA establish internal control procedures to monitor item managers' actions on computer-generated potential excess reports. DLA instructed its centers to develop monthly summary listings of the computer reports. Item managers were to include a brief description of the specific action taken, and retain the annotated copies of summary reports for 12 months. According to headquarters officials, they believed that all centers had complied with their original directive. Additionally, according to the officials, they intended to verify center compliance with the internal control procedures through periodic site visits, but did not do so because of other priority work.

In March 1988, we advised DLA headquarters officials that item managers at the Personnel Support Center were not routinely reviewing the computer reports that indicated potential excess on-order materiel. Also, we reported Center managers were not always annotating on summary reports the corrective actions taken. On March 25, 1988, DLA directed its supply centers to submit monthly reports summarizing terminations or other corrective actions. With the exception of the Personnel Support Center's Clothing and Textile Directorate, the supply centers have complied. According to Directorate officials, it submitted one report for May 1988, and as of January 1989 had not submitted supplemental information because of higher priority work load commitments.

In commenting on a draft of our report, DOD said that the Clothing and Textile Directorate is now in compliance with the March 25, 1988, directive. Also, DLA will issue guidance to its supply centers emphasizing the importance of monitoring the review of excess on-order actions.

DOD Has Issued an Excess On-Order Policy

In August 1986, DOD asked the Logistics Systems Analysis Office to review practices and procedures followed by the services in terminating orders for excess materiel. The Office suggested that DOD issue a policy on processing terminations for excess materiel on order. Also, in commenting on our August 1987 Air Force report, the Assistant Secretary of Defense (Production and Logistics) stated that DOD would issue policy guidance to balance the objective of preventing the acquisition of significant excess materiel with the objective of avoiding contract termination costs when materiel is likely to be required and procured again within a short period of time.

In September 1987, the Under Secretary of Defense for Acquisition sent a draft DOD instruction to the military services and DLA for comment and received favorable comments from the services. According to the draft instruction, ongoing contracts for materiel should be considered for termination when current requirements are significantly less than originally predicted. The services would have to identify, through their automated requirements systems, excess materiel on order. Item managers would have to consider the reliability of computerized requirements data, the extent of excess materiel on order, and the economic trade-offs in determining whether unneeded materiel should be accepted into the supply system. (Economic trade-offs include the costs for procuring and storing materiel versus the termination costs.)

The draft instruction also stated that contracting officers would have to obtain timely termination cost estimates from vendors. The item manager and contracting officer would have to jointly decide whether termination costs are reasonable. Finally, wholesale level inventory control points would be required to establish a terminations coordinator to manage, monitor, and audit termination actions and ensure accountability of termination decisions. A DOD supply policy official stated that DOD will decide when it will issue and finalize its draft instruction on terminating excess materiel on order by December 15, 1989.

On December 13, 1989, DOD issued a memorandum to the military departments and DLA on terminating contracts for secondary items no longer needed. The memorandum includes guidance on determining what are unneeded items as well as on procedures used to consider terminating contracts for unneeded items.

Conclusions

DLA does not have the data it needs to determine whether item managers and contracting officers are making progress in terminating unnecessary contracts and orders for excess materiel before delivery. DLA supply centers are frequently not taking effective and timely action to avoid premature expenditures for unneeded materiel. Even though item managers have recommended that contracting officers terminate some excess materiel on order, they often did not recommend terminations when it would have been appropriate, especially when termination costs were involved.

When contractors did not agree to no-cost contract terminations, contracting officers generally did not determine termination costs. Therefore, no cost benefit analyses were made to determine if termination was in the government's best interest, and item managers did not direct the contracting officers to terminate the contracts. Sometimes item managers changed requirements data without justification and proper supervisory review and approval. Also, local policies do not require all excess materiel on order be recommended for termination, when it is in the government's best interest.

Recommendations

We recommend that the Secretary of Defense instruct the Director, DLA, to

- implement the DOD policy and require development and implementation of a cost comparison methodology or model to assist supply center personnel in making cost-effective termination decisions;
- require contracting officers to obtain termination costs, in appropriate cases, so item managers can make cost benefit analyses; and
- continue to stress the importance of timely and accurate processing of potential excess on-order reports.

Agency Comments and Our Evaluation

DOD generally agreed with our findings and recommendations. DOD agreed that improvements are needed to determine when excess items on order should be terminated. DOD issued a policy memorandum on December 13, 1989, to establish guidance in this area. Guidelines for determining the cost-effectiveness of proposed contract termination actions are included in the memorandum (see app. IV). We believe that, if properly implemented, this memorandum could result in the termination of excess materiel on order when it is in the government's best interest. Because DOD issued this policy guidance, we have deleted this recommendation from our report.

DOD also pointed out that reluctance to recommend terminations can be well founded, since demand fluctuations often result in near-term reprocurement actions. For example, it said that 33 percent of the items cited in our draft report as requiring termination action did not have any oversupply within 12 months of our review. Although we have not evaluated the accuracy of this data, we realize that demand fluctuations occur and can have a major impact on requirements and assets. However, item managers should make termination decisions in accordance with DOD and DLA policies and based on the best available information. Hindsight should not be used as justification for not making required termination decisions. Furthermore, it demonstrates the need for sound termination policy and a model for making cost benefit analyses that includes such items as the cost of near-term reprocurement actions.

In addition to the reprocurement actions, DOD said that item managers have occasions when they do not have the option to terminate. For example, items include those with eminent deliveries and those whose manufacturers have ongoing legal problems, such as bankruptcy and debarments. In such circumstances, when item managers place additional orders to ensure an adequate supply, the computer may reflect an oversupply. According to DOD, the item manager should be allowed to judge whether to maintain such orders. We agree that item managers should be allowed to manage their items and that their judgment is important. However, we reviewed all available documentation on the decisions not to terminate the excess materiel and discussed these examples with the item managers. We found that imminent deliveries, bankruptcy, or debarments were not documented as reasons for not recommending termination. Therefore, these examples are included in our final report.

DOD said that it will implement our recommendations concurrently, which will be accomplished by providing DLA guidance to the supply centers by January 15, 1990. DOD also said that by March 31, 1990, DLA would provide guidance to its supply centers stating that contracting officers should determine termination costs. Moreover, DOD pointed out that with the exception of the Construction Supply Center the termination thresholds at DLA's other centers are quite similar in adhering to the normal procurement cycle reviews which indicate termination may be required. According to DOD, the Construction Supply Center's policy was considered appropriate for that center in view of its work load and personnel resources.

While we did not review all of the supply centers' termination policies, as pointed out in the report, the Construction Supply Center's policy excluded almost all of its procurements from termination consideration.

Sample Design and Data Analysis

To evaluate the Defense Logisitics Agency's (DLA) procedures for identifying excess materiel on order, we developed a universe of potential excess at each DLA location from computer-generated summary reports for April or May 1988. To chose our sample, we

- included contracts only over $5,000, since guidelines for contracts under $5,000 vary by center;
- stratified each universe into four subgroups based on dollar value and randomly sampled orders from within each subgroup;
- determined the sample size for each Center based on preliminary analysis and the time that would be needed to analyze each case; and
- allocated the sample among the subgroup to ensure that a reasonable number of higher dollar value orders would be in the sample.

Because all indications were that there was a great deal of excess materiel on order, our sample was designed to show the general magnitude of the excess rather than a precise value, which would have required much more work.

At the Electronics Supply and Personnel Support Centers we used reports as of April 1988. At the Construction Supply Center we used May 1988 reports since April reports were not prepared for the complete range of potential excess on-order items.

For each sample item that was potentially overprocured, we analyzed the accuracy of requirements data which resulted in the item being classified as potential excess on order. This analysis included reviews of back-up data contained on standard supply control studies, item history records, procurement files, and discussions with item managers. We also documented, to the extent possible, the action that was taken by the item managers in relation to the selected due-in study and determined whether or not such action was reviewed by management.

We then used asset information to compute the actual excess on-order dollar amount for each sampled item. For the Electronics Supply, Construction Supply, and Personnel Support (Medical) Centers, the asset information was consistent with the date of sample selection. For the Personnel Support Center (Clothing & Textiles), we had to use asset information as of September 1988 since April data were not available. This delay did not distort our results since all items found to be in an excess status in September 1988 were also reported as potential excess on order in April 1988.

Our computations compared available assets on hand and due in to the current forecast requirements often referred to as the peacetime acquisition objective. In determining current requirements, we provided for expected demands during the administrative and production lead time, special program requirements, current backorders, protected war reserve requirements, and a safety level to provide for unexpected peaks in demand patterns and a procurement cycle quantity. The various requirement factors were obtained from standard supply control studies and validated through discussions with item managers and reviews of documentation supporting recent purchases.

We used accepted estimation techniques for a stratified random sample to estimate the actual total dollar value of excess on-order materiel at each center. Sampling errors were computed at the 95-percent level of statistical confidence. Universe and sample sizes and sample allocation among strata intervals are shown in appendix II.

To test the effectiveness of actions taken by DLA to terminate excess on-order procurements, we determined whether or not item managers had initiated cancellation or reduction requests for those items which were actually excess to current needs. We then followed up with the buyers or contracting officers to determine whether cancellation requests had been properly acted upon. To further test these procedures, we supplemented our initial random samples to include additional cases where records indicated inventory managers requested cancellation or reduction action. Finally, at the Construction Supply Center we evaluated the effectiveness of a locally developed and implemented mechanized status tracking system.

Potential Excess on Order Table of Supply Center Universe and GAO Sample Size April or May 1988

Dollars in millions

Supply center		Universe: Number of items	Universe: Value range	GAO sample: Number of items	GAO sample: Value range	GAO sample: Item manager recommended for termination
Construction	Over $500,000	8	$5.5	8	$5.5	$0.4
	$100,000 to $499,999	224	43.2	20	4.2	1.0
	$25,000 to $99,999	1,100	50.1	20	0.9	0.3
	$5,000 to $24,999	4,183	45.4	20	0.2	0.1
	0 to $4,999	887	2.9	0	0.0	0.0
Total		**6,402**	**$147.2[a]**	**68**	**$10.8**	**$1.8**
Electronics	Over $500,000	7	$4.8	7	$5.8	$2.3
	$100,000 to $499,999	166	30.3	20	4.5	0.3
	$25,000 to $99,999	990	46.1	20	1.0	0.2
	$5,000 to $24,999	3,320	38.2	20	0.2	0.4
Total		**4,483**	**$119.4**	**67**	**$11.5**	**$3.2**
Personnel—clothing & textiles	Over $500,000	144	$241.4	10	$12.5	$0.0
	$100,000 to $499,999	350	73.7	15	3.5	0.0
	$25,000 to $99,999	684	34.2	20	1.0	0.0
	$5,000 to $24,999	1,110	13.2	25	0.3	0.0
	0 to $4,999	875	2.0	0	0.0	0.0
Total		**3,163**	**$364.5**	**70**	**$17.3**	**$0.0**
Personnel—medical	Over $500,000	12	$17.0	5	$6.2	$0.0
	$100,000 to $499,999	97	19.5	10	2.0	0.2
	$25,000 to $99,999	222	11.3	20	1.0	0.2
	$5,000 to $24,999	284	3.7	20	0.3	0.1
	0 to $4,999	229	0.5	0	0.0	0.0
Total		**844**	**$52.0**	**55**	**$9.5**	**$0.5**

[a]Does not add due to rounding.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND LOGISTICS
(L/SD)

January 5, 1990

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "INTERNAL CONTROLS: Status of DLA's Efforts to Control Excess Material On Order," Dated November 6, 1989 (GAO Code 391611), OSD Case 8171. The DoD generally concurs with both the findings and recommendations of the draft report.

The DoD agrees that improvements are needed in the consideration of terminating unneeded items which are on-order. To that end, the DoD issued a policy memorandum on December 13, 1989, to establish guidance in this area. Guidelines for determining cost-effectiveness of proposed contract termination actions are included in the memorandum.

The DoD also agrees that improvements are needed in supervisory reviews of termination decisions and item manager actions on termination recommendations. By January 15, 1990, the Defense Logistics Agency will issue guidance emphasizing the importance of supervisory reviews and monitoring of excess-on-order actions. The Defense Logistics Agency will include the excess-on-order program in the Agency 1990 Statement of Assurance.

The findings and recommendations are addressed in greater detail in the enclosure. The DoD appreciates the opportunity to comment on the draft report.

Sincerely,

R.L. Beckwith
Major General, USMC
Military Deputy

Enclosure

GAO DRAFT REPORT - DATED NOVEMBER 6, 1989
(GAO CODE 391611) OSD CASE 8171

"INTERNAL CONTROLS: STATUS OF DLA'S EFFORTS TO CONTROL EXCESS MATERIAL ON ORDER"

DEPARTMENT OF DEFENSE COMMENTS

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FINDINGS

Now on pp. 2, 11-13.

FINDING A: Most Orders For Excess Material Are Not Recommended For Termination. The GAO explained that, based on available information, in order to avoid buying unneeded supplies (items which may no longer be needed), the Defense Logistics Agency computer system identifies items for possible termination that are on order. According to the GAO, when the system identifies items that are potentially excess, item managers are supposed to review the computer data and, if appropriate, direct contracting officers (1) to terminate the contract if no costs are involved or (2) to evaluate any costs to determine if termination is in the best interests of the Government. The GAO cited several prior reports, 1/ that have previously identified and discussed significant weaknesses in DoD policies and procedures for identifying and processing procurement terminations for excess material on order. For its latest review, the GAO sampled potential excess material on order listed on computer generated summary reports at three Defense Logistics Agency supply centers for April or May 1988. The GAO estimated that, from a universe valued at \$683.1 million for contracts over \$5,000, about \$326 million, plus or minus \$122.6 million, was actually excess material. The GAO found, however, that item managers recommended only \$49.9 million to contracting officers for termination. (The GAO noted that its sample was designed only to show the general magnitude of the excess, since determination of a precise value would have required much more work.) (pp. 2-3, pp. 17-19/GAO Draft Report)

1/ GAO/NSIAD-84-41, "Defense Logistics Agency Could Better Identify and Cancel Unneeded On-Order Material," Dated January 10, 1984 (OSD Case 6370)

Enclosure

GAO/NSIAD-85-55, "The Navy Can Increase Cancellations of Procurements for Unneeded Material," Dated March 22, 1985 (OSD Case 6670)

GAO/NSIAD-87-141, "Air Force Should Terminate More Contracts for On-Order Excess Spare Parts," Dated August 12, 1987 (OSD Case 7242)

DoD Response: Concur. It should be noted, however, that there are valid reasons for many items originally categorized as unneeded not being terminated. At Defense Logistics Agency Supply Centers, some 40 percent of items reviewed for potential overprocurement do not become candidates for termination. The most common reason for this is adjustment of file data due to revised requirements or inventory position information.

FINDING B: Items Managers Are Reluctant to Recommend Terminations. The GAO discussed several ways that item managers avoided termination recommendations. The GAO found a number of instances where item managers questioned requirements data--but did not recompute the requirements based on correct information. According to the GAO, in these cases supervisors either did not review, or did not change, the decisions of item managers. The GAO also discussed several examples involving solenoid valves, hospital gowns, women's dress shirts, and utility trousers--noting that, in these cases, the item managers decisions resulted in a 1 year to 33 year over supply of the items. The GAO also found instances where item managers sometimes deliberately increased requirements so the computer would not identify certain items as being on order and overstocked. The GAO discussed examples involving aircraft refueling hoses, fire retardant shirts, and Coast Guard coats--where the item manager actions again resulted in unneeded supply of the items. The GAO pointed out that accurate computer data are essential for the Defense Logistics Agency supply system to function properly. The GAO concluded that, because of lax or nonexistent supervision, such questionable decisions not to recommend terminations are not being reversed. (pp. 2-3, p. 17, pp. 19-25/GAO Draft Report)

Now on pp. 3, 14-17.

DoD Response: Partially concur. The DoD agrees that accurate computer data are essential for the Defense Logistics Agency supply system to function properly. When the item manager's review of data results in the determination that corrections are required, file maintenance actions must be taken. As discussed in the DoD response to Finding A, these corrections may result in termination actions being not required or advisable. To the extent that such file corrections are not being made, or not being made correctly, the DoD concurs that corrective action is required. Guidance provided, as outlined in the DoD response to Recommendation 1, will include a reminder that file corrections should be reemphasized. This guidance will be provided by January 15, 1990.

It should be noted, however, that reluctance to recommend terminations can be well-founded, since demand fluctuations often result in near-term reprocurement actions. For example, 33 percent of the items cited in the draft report as requiring termination action were no longer in an excess position within 12 months of the GAO review. At the Defense Construction Suuply Center, 11 items have reached reorder level; 5 have been bought more than once; and 2 have experienced backorders. To cite the examples highlighted in the Finding, the Defense Logistics Agency projects hospital gowns will be procured this fiscal year. In addition to reprocurement actions with attendant costs, item managers are faced with instances where termination is not an option. For example, the Coast Guard coats, for which a computer-generated potential excess notification was issued in April 1988, were delivered less than 30 days later. Termination at this stage was not feasible. Several items used as examples experienced ongoing legal problems (such as bankruptcy and debarments), which made delivery of on-order quantities questionable. In such circumstances, managers who place additional orders to ensure customer support may find that file data reflects overprocured status. The item manager should be allowed to use judgment to determine whether to maintain such orders.

<u>FINDING C</u>: <u>Supply Center Thresholds Reduce The Number Of Termination Recommendations</u>. The GAO found that termination thresholds established for identifying potential excess materials was another reason why some terminations were not recommended. The GAO explained that the Defense Logistics Agency has allowed each supply center to establish its own termination policies--thereby allowing the centers to program their computers to report an item as potential excess only when it exceeds certain limits. As an example, the GAO reported that the Electronics Supply Center computer identified items as excess only when their value exceeded $5,000. According to the GAO, the Defense Logistics Agency explained that this was done to allow the centers to focus termination decisions on high value orders, since they did not have sufficient resources to review all potential excess. The GAO also reported that the Construction Supply Center only pursued terminations if the value of the contract exceeded $25,000 and the value of the excess material was greater than $10,000. The GAO observed that this policy was established even

though (1) 98.5 percent of the Center's procurement awards were for $25,000 or less and (2) the Federal Acquisition Regulation states that contractiong officers should try to terminate contracts for excess material on order, unless the remaining work is under $2,000. According to the GAO, Construction Supply Center records show that item managers used the termination policies as the basis for not recommending terminations for $27.3 million of the $147.2 million of potential excess not considered for termination in May 1988. The GAO further observed that, had the Construction Supply Center adopted a $5,000 threshold similar to the other supply centers, it would have considered an additional 879 contracts, valued at $8.5 million, for termination. The GAO concluded that supply centers have not adequately implemented Defense Logistics Agency policy guidance for effective item manager and supervisory review, nor have Defense Logistics Agency officials adequately followed up at the supply centers to ensure that agency policies had been implemented as directed. (pp. 3-4, p. 17, p. 19, pp. 25-28/GAO Draft Report)

Now on pp. 2, 17-20.

DoD Response: Concur. As stated in the DoD response to Recommendation 1, the Defense Logistics Agency will issue guidance to its Supply Centers by January 15, 1990, emphasizing the requirement for supervisory reviews of termination recommendations. However, it should be noted that, with the exception of the Defense Construction Supply Center, the termination thresholds at the Defense Logistics Agency centers are quite similar in adhering to the normal procurement cycle reviews which indicate termination may be required. The policy developed at the Defense Construction Supply Center was regarded as appropriate for that Center in view of its workload and personnel resources.

FINDING D: Potential For More Contract Terminations. The GAO reported that, according to the Federal Acquisition Regulation, contracting officers should terminate orders for material that is no longer needed, when it is in the best interest of the Government--and should try to terminate the contract, unless the remaining work is under $2,000. The GAO further reported that, in addition, the Federal Acquisition Regulation recognizes the Government's obligation to reimburse contractors for costs incurred and provides guidelines on how much the contractor should receive for attempting to fulfill the contract. According to the GAO, however, during the last half of FY 1988, Defense Logistics Agency supply centers reported terminating contracts valued at only $65.8 million--even though item managers had requested that $253 million of contracts for excess material be terminated. The GAO also pointed out that the supply centers it reviewed paid little or no termination costs. The GAO observed that the failure to complete timely and cost effective procurement terminations, especially when termination costs were involved, resulted in the Defense Logistics Agency receiving, storing, and paying for items that were not needed to meet requirements.

According to the GAO, contracting officers are not providing information on estimated termination cost to item managers. The GAO cited several examples that resulted in the purchase of unneeded aircraft yoke subassemblies, catheter and needle packages, and rib cutting shears. The GAO pointed out that, when contractors rejected a no-cost termination--(1) contracting officers should have determined the termination cost and (2) the item manager should have performed a cost benefit analysis to evaluate whether terminationg the contract was in the best interest of the Government. The GAO found, however, that in most cases, contracting officers did not determine termination costs. The GAO concluded that the cost benefit analysis would have enabled the item manager to compare termination costs to the value of the unneeded stock and storage costs. The GAO further concluded that, when appropriate, contracting officers should have tried to negotiate termination costs with contractors, but this is not currently specified in DoD policy. Overall, the GAO concluded that the Defense Logistics Agency centers are frequently not taking effective and timely action to avoid premature expenditures for unneeded material. (p. 4, pp. 30-34, p. 40/GAO Draft Report)

Now on pp. 3-4, 21-22.

DoD Response: Concur. Federal Acquisition Regulation 49.101(b) states: "The contracting officer shall terminate contracts, whether for default or convenience, only when it is in the Government's interest." The Defense Logistics Agency recognizes the complexity involved in defining "the Government's interest" in cases where termination costs are involved, and has initiated a study to develop and design a "decision model" to better define when it is cost effective to terminate a contract. The "decision model" will be utilized by both the Inventory Managers and Contracting Officers to assist the termination decision-making process. The model is in the prototype stage and will be used in conjunction with current procedures at the test Center. As detailed in the DoD response to Recommendation 2, the model is scheduled to be deployed at the Defense Logistics Centers by June 30, 1990. The model is expected to significantly aid the decision-making process and enhance the timeliness of processing terminations when they are in the Government's interest.

<u>FINDING E</u>: <u>Supply Center Policies Concerning Termination</u>. The GAO found that each supply center has developed its own policies regarding termination costs. As an example, the GAO reported that, in December 1986, the Construction Supply Center requested policy guidance from the Defense Logistics Agency for terminating contracts for excess on-order material. According to the GAO, the Defense Logistics Agency stated that contracts within 90 days of delivery, or for less the $10,000, are poor candidates for termination, because of contractor-incurred costs and the small contract amount. The GAO noted that the Defense Logistics Agency also said that, when termination costs are substantial, further action should not be pursued--but should be pursued if the costs are nominal. The GAO reported that, in November 1987, the Construction Supply Center established its own policies--including a guideline to avoid terminating contracts valued at less than $25,000.

The GAO found that other Defense Logistics Agency centers have issued different termination policies. The GAO reported, for example, that in June 1988, the Personnel Support Center Medical Directorate established a policy that allows for termination costs up to 20 percent of the contract value. The GAO further reported that, in April 1988, the General Supply Center established a policy allowing termination costs up to 50 percent of the contract value for those contracts valued at $25,000 or less--while those over $25,000 are evaluated on a case-by-case basis. The GAO concluded that this is an indication that neither the Office of the Secretary of Defense, nor the Defense Logistics Agency, has established adequate guidance concerning contract terminations. (p. 4, p. 30, pp. 34-35/GAO Draft Report)

Now on p. 23.

<u>DoD Response</u>: Partially concur. Admittedly, there are variations between the Defense Logistics Agency Supply Centers in termination policies. However, the granting of management flexibility to determine specific thresholds at each Center is regarded as appropriate in view of variations in workload, personnel resources, and nature of the commodities managed by individual Centers. As detailed in the DoD response to Recommendation 1, Defense Logistics Agency Headquarters will issue guidance on contract termination policies and reviews to its Supply Centers by January 15, 1990. As detailed in the DoD response to Recommendation 3, DoD-wide guidance on contract termination policy was issued on December 13, 1989.

<u>Finding F</u>: <u>Timeliness Of Termination Requests</u>. The GAO found that most recommendations to terminate contracts took over 60 days to be

processed. As an example, the GAO reported that, from May to July 1988--at the Personnel Support Center Medical Directorate--item managers sent 45 requests to the buying branch to terminate excess orders. The GAO found however, that as of November 1988, contracting officers had not attempted terminations for 14 of the requests. The GAO noted that the Construction Supply Center has a computerized database of item manager termination recommendations. The GAO found that of the 345 recommendations, valued at $5.7 million for May through September 1988---281, or 81 percent, required over 60 days to complete. The GAO noted that the longest time required was 155 days, while only 7 percent were processed within 30 days. The GAO concluded that prompt processing of recommendations to terminate contracts is essential to avoid continued contractor costs for excess material. (p. 35/GAO Draft Report)

Now on pp. 23-24.

DoD Response: Concur. The DoD agrees that the prompt processing of recommendations to terminate unneeded items is essential to avoid continued contractor costs for such items. Based on the DLA's experience with the prototype, it is likely that certain parameters can be established for the processing of terminations. As detailed in the response to Recommendation 2, the Termination Model is to be implemented at DLA Supply Centers by June 30, 1990.

FINDING G: Continued Weaknesses In Internal Controls: Supervisory Reviews. The GAO reported that, in its 1984 report, "Defense Logistics Agency Could Better Identify and Cancel Unneeded On-Order Material" (OSD Case 6370), it found that the Defense Logistics Agency needed to establish internal controls, including effective supervisory reviews, to ensure that item managers take appropriate actions to avoid pruchasing unneeded items identified by the computer as on order and not yet delivered. The GAO acknowledged that the Defense Logistics Agency has established internal controls that, in part, required effective supervisory reviews. The GAO found, however, that inadequate supervisory reviews of item managers' decisions to terminate or not to terminate exceyss material on order at both the yConstruction and the Electronic Supply Centers are still occurring. yAt the Construction Supply Center, the GAO found that 18 of the 66 cases (27 percent) with May 1988 potential excess on-order reports did not have the required supervisory review--while 16 of 41 cases (39 percent) with April 1988 potential excess on-order reports at the Electronics Supply Center did not have the required supervisory review. The GAO also observed that the Personnel Support Center has not established a policy that required supervisors to document their review of completed item manager actions. The GAO concluded that, in

Now on pp. 10, 24.

the supply centers it reviewed, internal controls requiring effective supervisory reviews were still inadequate. (p. 12, p. 36/GAO Draft Report)

DoD Response: Concur. As detailed in the DoD response to Recommendation 1, Defense Logistics Agency Headquarters will issue guidance to the Defense Logistics Agency Supply Centers by January 15, 1990, emphasizing the requirement for adequate supervisory reviews of item manager decisions on contract terminations.

FINDING H: Continued Weaknesses In Internal Controls: Item Manager Actions On Termination Recommendations. The GAO reported that, also in its 1984 report (OSD Case 6370), it found that the Defense Logistics Agency had failed to terminate orders for excess material because it had ineffective internal controls to monitor item manager actions on computer generated termination recommendations. In its latest review, the GAO found that the computer potential excess on-order reports were not always reviewed by item managers, as required--at both the Electronics and the Construction Supply Centers. The GAO acknowledged that, in response to its 1984 report, the Defense Logistics Agency instructed its centers to develop monthly summary listings of the computer reports and to require that item managers include a brief description of the specific action taken and retain the copies for 12 months. The GAO reported that Defense Logistics Agency Headquarters official believed all the centers had complied with the original directive. The GAO also noted, however, that although these officials said they intended to verify center compliance with the internal control procedures, they did not do so because of other priority work.

The GAO reported that, in March 1988, it advised Defense Logistics Agency Headquarters officials the item managers were not routinely reviewing the computer reports and were not always annotating the corrective actions taken on summary reports. The GAO reported that, on March 25, 1988, the Defense Logistics Agency directed its supply centers to submit monthly reports summarizing terminations or other corrective actions. The GAO found that, with the exception of the Personnel Support Center Clothing and Textile Directorate, all the supply centers have complied. The GAO noted that, according to Clothing and Textile Directorate officials, one report for May 1988 had been submitted, but as of January 1989, it had not submitted supplemental information because of higher priority work load commitments. (p. 12, pp. 37-38/GAO Draft Report)

Now on pp. 10, 24-26.

DoD Response: Concur. The Clothing and Textile Directorate is now in compliance with the March 25, 1988 directive. As detailed in the DoD response to Recommendation 1, the Defense Logistics Agency Headquarters will issue guidance to the Supply Centers by January 15, 1990, emphasizing the importance of monitoring review of excess-on-order actions.

FINDING I: The DLA Self-Assessment of Internal Controls. The GAO reported that, in response to Federal Managers' Financial Integrity Act Requirements, in March 1987, the Defense Logistics Agency Headquarters asked the supply centers to include the excess on-order program in their FY 1987 internal control program reviews. According to the GAO, none of the centers identified any material weaknessess for the program in FY 1987. The GAO found that, in FY 1988, however, the Defense Personnel Support Center reported a material weakness: it sometimes awarded contracts for material that was needed at the time of the initial purchase, only to have requirements change before the contracts were finalized. In addition, the GAO reported the Center also indicated that management personnel lacked adequate oversight of actions taken by item managers in response to due-in reports of potential excess. (The GAO noted these weaknesses were highlighted, in part, as a result of the GAO review.) According to the GAO, the Center proposed two actions to strengthen internal controls, as follows:

- increase management oversight and emphasis to reduce the dollar value of due-in reports; and
- develop a check within the computer system to prevent awarding contracts for excess material.

The GAO also reported that, although the Construction Supply Center did not identify it as a material weakness, the internal control review concluded that the importance of accurately determining requirements needed to be reemphasized to item managers.
(pp. 11-12/GAO Draft Report)

Now on pp. 9-10.

DoD Response: Concur. The DoD policy memorandum on contract terminations of unneeded items emphasizes the need to review high value contracts prior to award to confirm requirements. Corrective actions to the specific internal weaknesses identified at the Defense Personnel Supply Center and the Defense Construction Supply Center will be implemented by March 15, 1990.

Now on p. 43.

FINDING J: Status Of The DoD Policy Concerning Excess On-Order Material. The GAO reported that, in September 1987, the Under Secretary of Defense for Acquisition sent to the Services and the Defense Logistics Agency for a comment on a draft DoD instruction concerning termination of orders for excess materials. The GAO reported that, according to the draft instruction, ongoing contracts for material should be considered for termination when current requirements are significantly less than originally predicted. The GAO explained that the Services would have to identify, through their automated requirements systems, excess material on order. In addition, the GAO noted the instruction would require item managers to consider (1) the reliability of computerized requirements data, (2) the extent of excess material on order, and (3) the economic trade-offs in determining whether unneeded material should be accepted into the supply system. The GAO further noted that the draft instruction also stated the contracting officers should have to obtain timely termination cost estimates from vendors and the item manager and contracting officer would have to jointly decide whether termination costs are reasonable. Finally, the GAO reported that, under the draft regulation, wholesale level inventory control points would be required to establish a terminations coordinator to manage, monitor, and audit termination actions and ensure accountability of termination decisions. According to the GAO, the DoD will decide by December 15, 1989, when it will finalize and issue the instruction. (pp. 39-40/GAO Draft Report)

DoD Response: Concur. The DoD issued a memorandum on December 13, 1989, to the Military Departments and the Defense Logistics Agency from the Assistant Secretary of Defense (Production and Logistics) clarifying DoD policy in this area. As detailed in the DoD response to Recommendation 3, the memorandum includes guidance on the determination of what are unneeded items as well as on procedures to be used in consideration of contract terminations of unneeded items.

must be terminated for delinquent contracts. The other centers reported considering terminations if the remaining work was more than $1,000 and $250.

According to the Construction Supply Center's records, item managers use the termination policies as the basis for not recommending procurement terminations of a significant amount of excess materiel on order. For example:

- The Center did not try to terminate 172 unneeded light armored vehicle adjuster linkages valued at $5,500. The computer reported them as potential excess in May 1988. The item manager did not recommend termination because the contract value was under $25,000. The 172 unneeded items represented a 7-year supply.
- In May 1988, the Center did not try to terminate an order for 27 aircraft linear actuator pistons because more than half of the production lead time had passed. The item manager's decision complied with the Center's policy. However, the pistons valued at $50,000 may not be needed for many years, if ever. The demand for this item is low and the item manager's requirements showed that only three pistons were needed. As of May 1988, the Center had 198 pistons on hand and 27 on order. The 225 unneeded pistons represented a 74-year supply.
- The Center had seven Trident submarine solenoid valves valued at $71,427 due in under a contract that was delinquent because the contractor failed to meet the delivery date. As of May 1988, only three of the on-order valves were needed. The item manager did not recommend terminating the order for the four excess valves because he could not recommend a partial reduction to a delinquent contract. The four unneeded valves represented a 2-year supply.

Our analysis of the Construction Supply Center's May 1988 excess on-order summary report shows that $27.3 million of the Center's $147.2 million potential excess on order was not considered for termination because of the Center's termination policy. Table 2.2 shows the contracts not recommended for termination.

(purchase requests) prior to contract award, and to consider reducing or terminating contracts after award. In accordance with guidance in the Federal Acquisition Regulation, contracts should be terminated only when such action is in the Government's interest. Cost-effectiveness should be the primary, but not necessarily sole, factor in determining the Government's interest.

Now on pp. 4, 27.

Recommendation 4: The GAO recommended that the Secretary of Defense instruct the Director, Defense Logistics Agency, to implement the DoD policy and require development and implementation of cost comparison methodology or model to assist item managers in making cost effective termination decisions. (p. 5, pp. 41-42/GAO Draft Report)

DoD Response: Concur. As stated previously in the DoD response to Finding D, the Defense Logistics Agency has under development a cost comparison model for assisting in cost-effective termination decisions. The model is scheduled to be implemented at the Defense Logistics Agency Supply Centers by June 30, 1990.

Now on pp. 4, 27.

Recommendation 5: The GAO recommended that the Secretary of Defense instruct the Director, Defense Logistics Agency, to require contracting officers to obtain termination costs so item managers can make cost benefit analyses. (p. 5, p. 42/GAO Draft Report)

DoD Response: Concur. Contracting officers should determine what termination costs are involved. Specific guidance on this issue will be provided by the Defense Logistics Agency Headquarters to the Supply Centers by March 31, 1990.

Now on pp. 4, 27.

Recommendation 6: The GAO recommended that the Secretary of Defense instruct the Director, Defense Logistics Agency, to continue to stress the importance of timely and accurate processing of potential excess on order reports. (p. 42/GAO Draft Report)

DoD Response: Concur. Implementation of Recommendations 1 and 6 will be concurrent, and will be accomplished through the Defense Logistics Agency Headquarters guidance to Supply Centers by January 15, 1990.

* * * * * *

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense instruct the Director, Defense Logistics Agency, to require centers to ensure that supervisors review item manager decisions not to recommend termination or not to terminate excess material on order--as well as their termination decisions, as required by Agency policy. (p. 5, p. 29/GAO Draft Report)

Now on pp. 4, 19.

DoD Response: Concur. The Defense Logistics Agency will take actions to incorporate review of excess-on-order actions into the Agency Internal Control Program. Additionally, Defense Supply Centers will be advised that timely and effective supervisory review for both termination/non-termination decisions, and processing of actual termination actions, will be enforced. Reportable tracking mechanisms will be put in place for purposes of monitoring progress. The estimated completion date is January 15, 1990.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense instruct the Director, Defense Logistics Agency, to review and approve locally implemented operating procedures that limit the dollar value of termination requests initiated by item managers. (p. 5, p. 29/GAO Draft Report)

Now on pp. 4, 19.

DoD Response: Concur. As discussed in the DoD response to Finding D, the deployment of the Termination Model, currently being prototyped, will eliminate the need for locally developed threshold values and accompanying procedures. The deployment date for the model at the Defense Logistics Agency Supply Centers is projected to be June 30, 1990.

Recommendation 3: The GAO recommended that the Secretary of Defense issue a policy directive requiring item managers to make timely and cost effective termination decisions. (p. 5, p. 41/GAO Draft Report)

DoD Response: Concur. As discussed in the response to Finding J, the DoD has issued a memorandum stating DoD policy in this area. The determination of what are unneeded items will be made by the inventory manager as a result of reviews of requirements data. When changes in mission, consumption factors, etc., make all or part of material on order unneeded, DoD policy is to reduce or cancel orders

2

The contracting officer should terminate contracts only when such action is in the Government's best interest. Termination costs should be obtained in a timely manner in order to establish the cost-effectiveness of termination. In deciding whether to terminate unneeded items, such factors as the following should be considered: (1) the cost to complete the contract including ownership costs (storage, interest, etc.) versus termination costs, plus reprocurement costs, if appropriate; and (2) the potential need for the items on other contracts.

Please ensure that this guidance is transmitted to appropriate personnel.

Jack Katzen
Assistant Secretary of Defense
(Production and Logistics)

DOD December 13, 1989, Policy Memorandum, Contract Terminations of Secondary Items No Longer Needed

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND LOGISTICS

December 13, 1989

(L/SD)

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (RD&A)
ASSISTANT SECRETARY OF THE NAVY (S&L)
ASSISTANT SECRETARY OF THE AIR FORCE (AQ)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Contract Terminations of Secondary Items No Longer Needed

Recent reports by the DoD Inspector General and the General Accounting Office have emphasized the need for more consideration of contract terminations for secondary items no longer needed. We must take all possible steps to avoid unnecessary expenditures of scarce resources.

It is DoD policy to reduce or cancel orders (purchase requests) prior to contract award and to consider reducing or terminating contracts after award when changes in mission, consumption factors, etc., make all or a part of the material ordered unneeded. Inventory Control Points (ICPs) should establish procedures to manage, monitor, and audit termination actions within the activity. The procedures should provide for appropriate records to ensure accountability of termination decisions and the coordination of termination actions across functions. Termination decisions should be reached and implemented in a timely manner.

The replenishment review process at the ICPs should identify unneeded items during all phases of solicitation and contract award. Reasonable thresholds for review of unneeded items shall be established. Before award of high value contracts, inventory managers will validate the requirements data (including security assistance and Government Furnished Material requirements) used to compute order quantities and will cancel or reduce orders for unneeded items as appropriate. At the time of award of high value contracts, requirements data will be reviewed by the inventory managers and adjustments made to the contract award quantity as required. Following contract award, if inventory management reviews disclose that items under contract are unneeded, termination action by the contracting officer should be requested.

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