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DEFENSE INVENTORY:

DOD Needs To Continue Efforts To Improve Its Requirements Determination and Ordering Processes

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss inventory management issues in the Department of Defense (DOD) and our conclusion that the Congress needs to encourage DOD to stop buying items that it does not need or sooner than it needs them so as to avoid having on hand large amounts of unrequired inventory.¹ As I wrote to you on January 28, 1992, we believe the appropriations for DOD secondary items in fiscal year 1993 should be at least \$5 billion less than the appropriations for fiscal year 1992. As you know, I recently discussed inventory management issues before the Senate Committee on Appropriations and Senate Committee on Armed Services. My testimony today will follow some of the same lines of my earlier testimonies, but it will specifically address our work on the long-standing problems with the requirements determination and ordering processes for DOD inventory.

We have been reporting on problems with DOD's inventory management for a long time. Over the last 20 years, we have issued more than 130 reports dealing with these problems. Although DOD has recently taken steps to improve inventory management, we see the problems to be of such magnitude that we have identified defense inventory management as 1 of 16 government activities that are highly vulnerable to mismanagement, fraud, and abuse.

In May 1991, we summarized 97 reports issued over the preceding 6 years by GAO and the defense audit agencies on DOD's inventory requirements determination processes. These reports contain many specific examples of problems with the requirements determination processes. These reports highlighted the following serious problem areas with the requirements determination processes:

¹The amount of DOD's unrequired inventory has been widely reported as \$35 billion. This was based on DOD's September 30, 1989 inventory report which showed that DOD had \$109.5 billion of secondary item inventory, of which about \$34.3 billion was reported as unrequired. DOD has since reported that, as of September 30, 1990, it had a secondary item inventory of \$101.9 billion, of which about \$30 billion was reported as unrequired. Most of the difference between the two inventory amounts, both total and unrequired, was due to a revaluation of inventory. GAO had recommended that DOD revalue its inventory and we do not disagree with the change; however, it should be recognized that most of the reduction is a valuation change and not an actual reduction. On February 28, 1992, the DOD Comptroller testified that there have been further reductions in secondary item inventory. However, the September 30, 1991 report has not yet been released.

- Inaccurate or unsupported data in the requirements system caused misstated inventory requirements. For example, in our March 1990 report on growth in the Army's inventory, we pointed out that erroneous information in the Army's Aviation Systems Command data base caused the requirements system to compute incorrect requirements levels for 6 of the 45 items reviewed. As of September 30, 1988, the Aviation Systems Command reported about \$26 million of unrequired inventory for these six items.
- Management personnel overrode computational models used to determine inventory requirements. For example, the Army Audit Agency reported in 1988 that one commodity command's failure to use accurate logistics data in computational models had led to the significant overstatement or understatement of resulting requirements.
- There was inadequate consideration of an item's essentiality when ordering spare parts. For example, a May 1990 Air Force Audit Agency report showed that war reserve requirements were overstated by \$19.7 million because inadequate guidance and training was provided regarding the importance of using accurate essentiality codes when computing war reserve requirements.
- Item managers failed to cancel unnecessary or excess on-order material. Failure to cancel unnecessary or excess on-order materials is a long-standing problem that we have been reporting on at least since 1974 as I will discuss later in this testimony.
- Management controls were ineffective. DOD promised corrective actions in response to recommendations, and it has made improvements in some specific areas, such as improving or amending policies or procedures. However, these corrective actions have not been effectively implemented, and the basic problems remain. The deficiencies we summarized in a May 1991 report covering work by us and defense audit agencies on DOD's requirements determination processes are similar to those summarized in a September 1984 DOD/Office of Inspector General report.

The following sections of my testimony will go into more detail about five specific problem areas where there have been long-standing problems. These areas include not using excess retail inventories to reduce requirements, not terminating contracts for excess-on-order material, buying spare parts too early, excessive lead times resulting in buying too much, and not reducing buys where unserviceable assets could be repaired cheaper than buying new items.

EXCESS RETAIL INVENTORIES

Our work has shown that excess stock occurs at retail levels and sometimes the wholesale level is buying these same items. We have reported on this problem in both the Army and Air Force. In January 1981, we reported that the Army had made little progress in resolving previously disclosed retail inventory management problems and that \$55 million of \$290 million of stock excesses at Army retail activities could have been used in place of new procurements to satisfy critical Army-wide shortages. In January 1990, we reported that 13 Army divisions had \$184 million worth of spare and repair parts that were excess to their needs and had not been reported to the buying commands. At the same time, we found that three Army buying commands were in the processes of procuring 1,669 of these same items worth \$66.9 million.

In July 1991, we reported that between September 1987 and March 1990, inventories of consumable items and low-cost equipment that were excess to Air Force retail activities' war reserve and peacetime operating needs increased from \$442 million to \$927 million, or 110 percent. Wholesale item managers had visibility over only a small portion of the retail-level excess. As a result, wholesale managers procured items valued at millions of dollars that were excess at retail-level activities and opportunities for redistributing assets were missed. For example, we compared retail-level excesses on hand, valued at \$108.3 million, at 14 retail activities as of March 31, 1990, with procurement actions being taken at the wholesale level and found that there were ongoing or planned procurements for \$32.1 million, or 29.6 percent, of these retail excesses. The wholesale managers were aware of only \$1.5 million, or about 5 percent, of the \$32.1 million in retail excess.

UNNEEDED BUYS NOT CANCELED

We have been reporting on DOD's need to cancel orders for unneeded buys since at least 1974. In August 1987, we reported on a sample of 70 items with excess-on-order amounts over \$1 million with a total value of \$103.2 million at two air logistics centers. We found that the air logistics centers had terminated the procurement of only \$1.8 million, or less than 3 percent of the sample. Our analysis showed the Air Force should have terminated an estimated additional \$24.9 million, or about 24 percent, of the \$103.2 million excess-on-order spare parts.

More recently, in March 1990 we reported how the Defense Logistics Agency item managers were increasing stated requirements to avoid recommending terminations. Lax or nonexistent supervision allowed questionable decisions not to recommend terminations to go unreversed. At one supply center, contracts were not considered for termination if they fell below \$25,000, a threshold that excluded 98.5 percent of the center's contracts.

In its March 1991 report on progress in inventory reduction, DOD stated that it is terminating more contracts and that the Defense Logistics Agency reported \$100 million less in excess-on-order material at the end of fiscal year 1990 (compared to fiscal year 1989). These appear to be positive steps. However, we recently reviewed the March 1991 inventory reports and found that DOD still had \$2.5 billion of material on order that was excess to requirements.

BUYING SPARES TOO EARLY

We have been reporting on DOD buying spare and repair parts too early for many years with reports recommending reduced initial buys of spare parts going back to at least 1972. In June 1972, we reported that much of the backup equipment and spare parts acquired by the Navy as initial support was seldom, if ever, used and quantities procured could have been significantly reduced without impairing fleet readiness.

More recently, we reported in August 1989, that based on our analysis of 31 items procured by the U.S. Army's Tank-Automotive Command, the Command had prematurely invested more than \$87 million in spare and repair parts. Because of subsequent reductions in requirements, about \$30 million in parts, or more than 34 percent of the original purchase amount, were ultimately deemed to be unnecessary to meet the Command's revised requirements.

EXCESSIVE LEAD TIMES

We have been reporting on problems with DOD's lead time determinations for many years. For example in August 1982, we reported that inaccurate administrative lead times being used to determine inventory needs at one air logistics center resulted in unnecessary procurements of up to \$6.3 million to accommodate the excessive lead time. In June 1983, we reported inaccurate production lead time at two air logistics centers. We identified overstated requirements of \$137.5 million, understated requirements of \$12 million, and \$17 million of extra parts as safety level stock due primarily to the use of outdated lead time data in computing requirements.

In May 1990, we reported that the Navy's administrative lead time estimates were not accurate and inventory records were not correct. Our analysis of 2,467 Aviation Supply Office purchases showed that actual administrative lead times for 863 purchases (about 35 percent) varied from the standards by at least 6 months. During one period, the Supply Office added 9 months to the administrative standard for all purchases because funds were available. This action resulted in a 25-percent increase in purchases reviewed by us.

In another analysis of 150 randomly selected items for the May 1990 report, we found that shipment and receipt records in the contract status file did not agree for 122 (about 80 percent) of the items. We projected that about 4,200 items, involving purchases of \$487.5 million, had file discrepancies. Incomplete and inaccurate inventory records further hamper lead time forecasting. Without reliable data, the Aviation Supply Office does not have reasonable assurances that the procurement system is adequately protected from mismanagement, waste, and abuse.

In May 1990, we reported that DLA had not implemented adequate controls to manage and minimize procurement lead times as directed by DOD. Lead times for sample items at two DLA supply centers were either overstated or understated, thus increasing the risk of buying too much or too little stock.

BETTER REPAIRABLES MANAGEMENT NEEDED

In June 1977, we reported that the Air Force continued to repair parts when more serviceable parts were available than were currently needed and that it could save millions of dollars if it used serviceable parts to meet needs. This report noted that this problem had been identified by GAO in 1964 and the Air Force Audit Agency in 1973, 1974, and 1975.

More recently, in November 1990, we reported that better management of the Army's unserviceable inventories could save millions of dollars. Specifically, the three Army inventory control points we visited identified 815 repairable items with buys in processes valued at \$216.8 million and with unserviceable assets on hand between June and November 1989. We randomly selected and analyzed 140 of these items and found that for 36 items, the item managers could have reduced procurements by repairing unserviceable assets instead of buying new ones. On the basis of our sample results, we estimated that the Army could have saved between \$21.1 million and \$35.9 million for the 815 items by repairing rather than buying assets.

WHAT CAN BE DONE

In the past year, we issued two reports where we compared commercial practices to what DOD had done for F-108 aircraft engines and medical supplies. In both cases, we found DOD could reduce inventory requirements and save millions of dollars by adopting commercial practices. We see tremendous potential for improvements in DOD's inventory systems which would translate into significant savings. DOD managers need to establish goals for reducing the inventory they are storing and maintaining. Achieving these goals will require them to:

-- stop buying items so far in advance;

- terminate orders for unneeded materials;
- change the organizational culture so they will have an efficient supply system and will not need to rely on overstocking to ensure being able to fill orders;
- rapidly increase the use of commercial practices in all the areas, such as medical, where commercial supply systems are well-established; and
- clear the warehouses of old, obsolete, and unneeded items.

We believe that the Congress needs to maintain close oversight of DOD's inventory management improvement efforts. Congressional attention is needed to sustain the momentum for reducing inventories and improving requirements determination and to keep top DOD management focused on this issue.

DOD has established an inventory reduction plan with goals to do many of the things I outlined above. This plan includes objectives to:

- minimize the quantity of new items entering the supply system,
- reduce the number of items currently in the system,
- reduce the quantities of material stocked,
- pursue commercial alternatives to material stockage, and
- improve material control and asset visibility.

DOD needs to continue its efforts to improve inventory management. At the same time, because DOD has so much unrequired inventory and continues to buy items it simply doesn't need, the Congress may wish to make a budget reduction to show how serious it is in its desire to see improvement in DOD's inventory management. Making budget reductions to achieve such improvements is not a new idea. Congress has done it. A number of private sector firms we surveyed, when they decided to cut inventory levels, set inventory reduction goals and reduced inventory dollars. DOD itself has used the technique of reducing the services' supply dollars to encourage increasing supply system efficiency.

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Mr. Chairman, that concludes my prepared testimony. I would be pleased to answer questions at this time.

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