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**United States General Accounting Office**  
**Washington, DC 20548**

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January 11, 2001

The Honorable Richard Danzig  
The Secretary of the Navy

Subject: Navy Aviation Spare Parts Billing Transaction Issues

Dear Mr. Secretary:

Earlier this year, we conducted a review of price trends for Navy aviation spare parts.<sup>1</sup> During the course of the review, we compared the prices customers were billed to the prices they should have paid according to the parts catalog maintained by the Naval Inventory Control Point-Philadelphia. In doing so, we identified thousands of billing transactions where the customers' price did not match the catalog price. Moreover, we found thousands of additional transactions in which key information used to generate accurate customer bills was missing. These findings suggest that the Navy may be incorrectly reporting its sales of aviation spare parts. This letter discusses our findings in greater detail and provides suggested actions the Navy can take to improve the accuracy of its billings.

### Background

The Naval Inventory Control Point uses billing transaction information to report its annual sales of spare parts.<sup>2</sup> These sales are made either at the net or the standard price. Customers pay the net price when they turn in a broken item to be repaired; otherwise they pay the higher standard price. In fiscal year 1999, the average net price was \$7,390 and the average standard price was \$29,888.

When customers order parts, they supply an advice code as part of the requisition process. The Inventory Control Point uses this code to determine whether customers will be billed at the net or standard price. The most common advice code, "5G," for example, indicates that the customer will turn in a broken part, in which case a bill is generated at the net price. Over 90 percent of the time, customers turn in a broken part and pay the net price.

We obtained from the Naval Inventory Control Point billing transactions for aviation spare parts covering fiscal years 1994 through 1999. These transactions, extracted from the Navy's Billing History File, were segregated into two categories – net and standard sales – for each

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<sup>1</sup> Defense Acquisitions: Prices of Navy Aviation Spare Parts Have Increased (GAO-01-23, Nov. 6, 2000).

<sup>2</sup> A transaction can be a bill or a bill reversal. The latter is used to correct billing errors.

of the 6 fiscal years. We also obtained catalog prices for each part over the 6-year period from the Navy's pricing file.

As a data quality check, we compared the prices customers were billed to the Navy's catalog prices. From fiscal year 1994 through 1999, we determined whether billing transactions identified as net sales matched the net price in the Navy's catalog. If the price billed to the customer did not match the catalog's net price, we determined if it matched the standard price. We performed the same analysis for transactions identified as standard sales.

Billing Transactions Were Mistakenly Identified As Net or Standard Sales

Of the more than 1.2 million transactions that the Inventory Control Point had identified as net sales, there were 4,368 transactions (0.4 percent) where the billing price actually matched the standard price in the catalog. More importantly, of the 347,756 billing transactions identified as standard price sales, 50,079 (14 percent) matched the net price in the catalog. As noted above, more than 90 percent of the Inventory Control Point's transactions are net sales. These mismatches indicate that transactions were incorrectly categorized as net sales rather than standard sales and vice versa. Table 1 summarizes our analysis for fiscal year 1994 to 1999.

Table 1: Number of Mismatches

Fiscal Year	Identified as Net Sale But Matched Catalog's Standard Price	Identified as Standard Sale But Matched Catalog's Net Price
1994	1	14,362
1995	37	22,303
1996	0	546
1997	8	618
1998	55	12,131
1999	4,267	119
Total	4,368	50,079

We discussed our findings with officials at the Inventory Control Point, focusing primarily on 1994, 1995, 1998, and 1999, the years with the largest number of mismatches. The officials confirmed that all billing transactions with advice codes indicating a turn-in of a broken part are identified as net sales, while transactions with all other advice codes are identified as standard sales. Due to resource constraints, the officials could not systematically determine the reason for all of the mismatches. However, they offered the following as possible explanations.

- In 1994 and 1995, we found a total of 36,665 transactions where the net price was billed but the transactions were identified as standard price sales. One explanation for these mismatches was that the Inventory Control Point introduced a new automated requisition system in the early 1990s and some errors may have occurred in the transition. However, the officials could not verify that this happened, since automated billing records are no longer available for those years and a substantial amount of manual effort would be required to research the files.
- In 1998, about 12,000 transactions were identified as standard sales when customers were actually charged the lower, net price. These 12,000 transactions translated to over \$101 million that was mistakenly counted as standard sales. The officials explained that in 1998 the Navy's automated requisition processing system would not allow a net bill to be issued for certain designated customers. Therefore, the system failed to properly issue bills at the net price for these customers. An analyst in the billing department fixed this problem by manually flagging each of the transactions with the "2J" advice code—a little-used code chosen to signal that a manual fix had been made. However, when the Inventory Control Point reported fiscal year 1998 sales, all of these transactions were identified as standard sales based on the "2J" code. We verified that there were about 12,000 billing transactions in 1998 with the 2J advice code.
- In 1999, we identified 4,267 transactions that were reported as net sales where the price billed to the customer matched the catalog's standard—rather than net--price. Inventory Control Point officials explained that the catalog price is sometimes changed during the fiscal year. They stated that this situation could account for the discrepancies we found, because the database provided to us by the Navy reflects catalog prices at the start of the fiscal year and does not capture the updated prices. For this reason, we were not able to validate whether the updated prices matched the price at which customers were billed. The officials said that when there is a mid-year price change, the Inventory Control Point is supposed to issue a bill reversal, which credits the customer for the old price. The customer would then receive a new bill based on the updated catalog price.

#### Billing Transactions Lacked Advice Codes

As noted earlier, when customers requisition parts, they supply an advice code to the Navy's automated requisition processing system. From the processing system, the advice code is perpetuated to other databases for supply and billing actions. We asked Inventory Control Point officials to provide us with a breakdown of transactions by advice code from fiscal years 1997 through 1999. In the 3-year period, about 36,000 of the more than 750,000 transactions did not have an advice code. These 36,000 billing records translated to \$168 million in sales.

In cases where the customer neglects to supply an advice code, bills are automatically generated at the standard price by default. If the standard price is mistakenly charged--that is, the customer turned in a broken part--the Inventory Control Point issues a bill reversal and then charges the customer the net price.

The Inventory Control Point has issued a substantial number of bill reversals. Of the billing transactions we obtained for our price trend review covering fiscal years 1994 through 1999, nine percent were bill reversals. These bill reversals totaled \$2.3 billion over the 6 years. Based on the data provided by the Navy, we cannot determine the extent to which these bill reversals were to correct billing errors resulting from missing advice codes. The Inventory Control Point also issues bill reversals for other purposes, such as canceled orders or inaccurate billing amounts.

### Conclusion

We identified thousands of transactions that were mistakenly identified as net or standard sales based on incorrect or missing advice codes. As a result of these errors, some customers have been billed at the incorrect price. Further, a substantial amount of administrative work at the Inventory Control Point has been required to issue bill reversals to correct the billing errors. These errors also raise questions regarding the accuracy of the Inventory Control Point's reported sales of spare parts. Because the advice code provides an important piece of information for supply and billing actions, the Inventory Control Point should take actions to ensure that this code is correct. A further concern is that, to the extent that net and standard sales are part of the calculation used to establish Working Capital Fund spare part prices for future years, these prices could be set too high or too low if the reported sales are incorrect.

### Recommendations For Executive Action

Since in the vast majority of cases customers turn in a broken part and are billed the net price, we recommend that the Navy Inventory Control Point-Philadelphia set the billing default to the net rather than the standard price when the advice code is missing. Taking this action would decrease the number of bill reversals and thus reduce the additional work and resources required to issue reversals. Furthermore, we recommend that customer requisitions without an advice code be flagged and tracked to ensure that the customers are billed at the appropriate price.

### Agency Comments

In written comments on a draft of this report, the Department of Defense (DOD) concurred with our recommendations. The Inventory Control Point has submitted a proposal to set the default to the net price when the advice code is blank. An automatic error notification will be triggered in this circumstance so that Inventory Control Point personnel can determine if the net price charge is valid. DOD stated that the time frame for implementing these changes has not yet been determined. DOD's written comments are enclosed.

We conducted our review from April 2000 to October 2000 in accordance with generally accepted government auditing standards. In conducting our review we met with officials and analysts at the Naval Inventory Control Point-Philadelphia, Pennsylvania.

This report contains recommendations to the Naval Inventory Control Point-Philadelphia. We are asking the Commander of the Inventory Control Point to inform us within 60 days of actions taken on our recommendations.

We are sending copies of this letter to the Honorable William S. Cohen, Secretary of Defense, and interested congressional committees. This letter will also be available on GAO's home page at <http://www.gao.gov>. Please contact me at (202) 512-4841 or Karen S. Zuckerstein at (202) 512-6785 if you or your staff have questions. Major contributors to this letter were Michele Mackin and Yeewan Tom.

Sincerely yours,

A handwritten signature in black ink, appearing to read "David E. Cooper". The signature is written in a cursive style with a large initial "D" and a long horizontal stroke at the end.

David E. Cooper, Director  
Acquisition and Sourcing Management

Enclosure

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Enclosure



COMPTROLLER  
(Program/Budget)

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JAN 5 2001

Mr. David E. Cooper  
Associate Director  
Defense Acquisition Issues  
National Security and International  
Affairs Division  
U. S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report on Defense Acquisitions, "Prices of Navy Aviation Billing Transactions," dated November 27, 2000 (GAO Code 120011, OSD Case 3010). The Department generally concurs with the recommendations contained in the draft report.

Specific comments on the recommendations contained in the GAO draft report are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

A handwritten signature in black ink, appearing to read "Bruce A. Dauer".

Bruce A. Dauer  
Deputy Comptroller

Enclosure

GAO DRAFT REPORT DATED NOVEMBER 27, 2000  
(GAO CODE 120011) OSD CASE 3010

“DEFENSE ACQUISITIONS: NAVY AVIATION  
SPARE PARTS BILLING TRANSACTION ISSUES”

DEPARTMENT OF DEFENSE COMMENTS  
TO THE GAO RECOMMENDATIONS

**Recommendation 1:** The GAO recommended that the Navy set the billing default to the net rather than the standard price when the advice code is missing. (p. 6/GAO Draft Report)

**Response:** Concur with comment. During the course of the GAO Audit, a small amount (approximately 0.4%) of issue transactions for aviation repairables processed to financial programs citing a blank advice code instead of a valid advice code. Currently in those situations, the financial programs default to triggering a bill at standard price. This logic is the opposite in supply programs such as requisition processing or carcass tracking. These programs default to a net price advice code if they receive a transaction with a blank advice code.

The GAO auditors requested we revise the financial programs’ logic to be the same as that of other programs. We agreed and submitted a project that will effect this change. An estimated date for the Fleet Material Support Office working this change proposal is not known at this time.

**Recommendation 2:** The GAO recommended that the Navy identify and track customer requisitions without an advice code to ensure that the customers are billed at the appropriate price. (p.6/GAO Draft Report)

**Response:** Concur with comment. The GAO auditors requested we revise the financial programs’ logic to be the same as that of other programs. We agreed and submitted a project which will effect this change. The revised program will also create an informational error for Inventory Control Point research when this occurs. The error notification will allow Inventory Control Point personnel to determine if the Net Price charge is valid and will assist in determining the originators of these improperly coded issues. An estimated date for the Fleet Material Support Office working this change proposal is not known at this time.

(120011)