

February 2000

DEPARTMENT OF
THE NAVY

Breakdown of
In-Transit Inventory
Process Leaves It
Vulnerable to Fraud



DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

DTIC QUALITY INSPECTED 3



G A O

Accountability * Integrity * Reliability

20000331 034



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

Office of Special Investigations

B-284112

February 2, 2000

The Honorable Richard J. Durbin
The Honorable Tom Harkin
United States Senate

The Honorable Peter A. DeFazio
The Honorable Carolyn B. Maloney
House of Representatives

In March 1999, we reported that the Department of the Navy was unable to account for over \$3 billion in inventory, including some classified and sensitive items, that was in transit within and between storage facilities, repair facilities, and end users.¹ During that review, we selected and reviewed 94 shipments, 79 of which the Navy, after further investigation, could not account for. Following the issuance of the report, the Navy reportedly obtained receipt information for 45 of the 79 shipments, leaving 34 shipments still unaccounted for. This report responds to your request that we conduct an investigation to (1) determine what happened to the 34 shipments that the Navy could not account for and (2) confirm that the Navy actually had receipt information for the 45 shipments. In subsequent discussions with your offices, we were also asked to include in our report Navy initiatives that address some of the specific control issues associated with in-transit inventory.

This report is also part of GAO's continuing effort to address defense inventory management as a high-risk area² because of vulnerabilities to fraud, waste, abuse, and mismanagement.

¹ *Defense Inventory: Navy's Procedures for Controlling In-Transit Items Are Not Being Followed* (GAO/NSIAD-99-61, Mar. 31, 1999).

² In 1990, GAO began a special effort to review and report on the federal program areas that it identified as high risk because of vulnerabilities to fraud, waste, abuse, and mismanagement. This effort, which was supported by the Senate Committee on Governmental Affairs and the House Committee on Government Reform, resulted in a much-needed focus on problems that were costing the government billions of dollars. GAO identified the Department of Defense's inventory management as a high-risk area at that time because levels of unneeded inventory were too high and systems for determining inventory requirements were inadequate.

Results in Brief

The Navy does not consider to be lost or stolen all items that are written off as losses in transit. Navy officials stated that in many instances the items in question were received but written off as lost because, contrary to requirements in Navy regulations, facilities involved in the movement, repair, and storage of in-transit items did not notify the Naval Inventory Control Point (NAVICP) in Philadelphia, Pennsylvania, that they had shipped or received items. Our investigation showed that the majority of the shipments written off as lost by NAVICP had in fact been delivered. We reviewed 23 of 34 shipments that the Navy could not account for and were able to determine the status of 20 shipments. We found that the shipments were delivered but, due to procedural and system problems, were not reported as received. We were unable to determine the disposition of the remaining three shipments because the Navy could not provide documentary evidence that would have enabled us to investigate these shipments.

During our previous review, Naval Supply Systems Command (NAVSUP) officials contended that some items written off as lost had actually been received. However, they could not provide evidence to validate their contention. They explained that their information was based primarily on telephone calls and e-mail messages from the issuing facilities to the intended recipients. During our investigation, we found their information to be primarily shipping information and not proof of either delivery or receipt. We reviewed 41 of 45 shipments that the Navy reported as accounted for and determined that 38 shipments had been delivered. However, we found that the shipments were either not reported or were reported inaccurately to NAVICP. We were unable to determine the disposition of the remaining three shipments because the Navy could not provide sufficient documentary evidence.

Although our investigation disclosed no evidence of theft in the shipments we reviewed, we believe that the inventory process is susceptible to fraud, waste, and abuse. In-transit inventory discrepancies reduce the reliability of Department of Defense (DOD) inventory financial reports by obscuring true inventory losses and misstating the number of items on hand.

Background

NAVSUP administers the Navy supply system and provides in-transit inventory management policies and procedures. NAVSUP, through its NAVICP, initiates purchases and directs inventory movement for its customers. Such inventory includes classified and sensitive items,³ such as aircraft guided-missile launchers, military night-vision devices, and communications equipment. Until the inventory reaches its intended destination and is reported as received, NAVICP refers to it as in transit. The recipient of the inventory is responsible for notifying NAVICP that it has been received. Such notification is an internal control designed to account for all in-transit assets.⁴ If within 45 days of shipment NAVICP has not been notified that a shipment has arrived, it is required to follow up with the intended recipient. The rationale behind this procedure is that until receipt of the inventory is confirmed, the exact status of the shipment is uncertain and therefore vulnerable to fraud, waste, and abuse. Navy policy stipulates that delinquent shipments should be written off as inventory losses if their receipts remain unconfirmed after 6 or 11 months, depending on their value. The Navy reported that between October 1995 and September 1998, it wrote off, as lost in transit, inventory valued at over \$3 billion.

Implementing inventory control is a shared responsibility of NAVICP and shipping and receiving facilities, which include the Defense Logistics Agency⁵ and Navy-managed facilities and repair facilities.

³ Classified items require the highest degree of protection in the interest of national security. Sensitive items—those items that have high values and that are highly technical or hazardous in nature—require a high degree of protection and control due to statutory requirements or regulations.

⁴ Receipt notifications are generally recorded in NAVICP's accounting and logistics records. Item managers use the receipt notifications in the records to maintain visibility, or keep track, of the items.

⁵ The Defense Logistics Agency operates and manages storage facilities. It receives, stores, and issues inventory and maintains inventory records.

The accountability problem with in-transit inventory is part of a larger problem. Since at least 1990, we have considered DOD inventory management to be a high-risk area because its inventory management systems and procedures are ineffective. The lack of adequate controls over in-transit inventory and the resulting vulnerability to undetected loss and theft have been major areas of concern. That lack of control substantially increases the risk that millions of dollars will be spent unnecessarily. Because DOD has not corrected these problems, section 349 of the Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 required DOD to submit a comprehensive plan to the Congress addressing how it will ensure visibility over in-transit inventory.⁶ DOD's Under Secretary for Acquisition and Technology submitted the plan to the Congress on September 14, 1999.

Shipments Not Accounted for by the Navy

NAVSUP and NAVICP officials do not consider as lost or stolen all items that have been written off as in-transit losses. These officials stated that in many instances the items in question were received but written off as lost because facilities involved in the movement, repair, and storage of in-transit items did not notify NAVICP that they had shipped or received items. Our investigation showed that the majority of the shipments that NAVICP could not account for had in fact been delivered. We reviewed 23 (valued at about \$1.7 million) of the 34 shipments and were able to determine the status of 20 (valued at about \$1 million) of them. We found that the 20 shipments had been delivered but, due to procedural and system problems, were not reported to NAVICP as being received. The Navy could not provide us documentary evidence necessary to review the remaining three shipments.

- Fourteen shipments containing unclassified cockpit video recorders and generators (valued at \$660,020) were delivered to repair facilities. However, the repair facilities did not report their receipt of the items to NAVICP because they were not contractually required to do so. For example, the Fleet and Industrial Supply Center in Norfolk, Virginia, sent 10 shipments containing aircraft cockpit video recorders to a commercial repair facility in Santa Clara, California. NAVICP officials explained that the repair facility at that time was not required to report

⁶ The Authorization Act requires that the Comptroller General review the plan and submit any appropriate comments to the Congress. That review is the subject of a separate GAO report that will be issued later this year.

shipment receipts. The officials further explained that they had not sought proof of shipment, delivery, or receipt for these shipments because they did not meet the specified dollar value threshold for follow-up. According to NAVICP officials, they had no way of knowing whether shipments to the contractor were received. Instead of obtaining proof of receipt, the officials periodically ran a special program that performs presumptive receipts for shipments. Using this program, a presumptive receipt is accomplished by posting a transaction, "administratively" indicating that material was received without NAVICP actually assuring its receipt. Records of some outstanding shipments are then closed based on presumed receipt even though there is no indication that the intended recipient actually received the material. However, NAVICP officials acknowledged that they either failed to run the program or the program failed to update the records of the 10 outstanding shipments. In any event, the shipments were written off.

- Four shipments containing classified aircraft guided-missile launchers and unclassified generators (valued at \$305,900) were sent from the Fleet and Industrial Supply Center and the Defense Distribution Depot in Norfolk, Virginia, to the Defense Distribution Depot in San Diego, California, for storage. Records show that receiving personnel signed for the shipments, but we found no evidence that they were subsequently recorded as received into inventory. In addition, depot personnel were unable to provide evidence that these shipments were properly stored and that the receipt of the shipments had been reported to NAVICP.
- Two shipments containing an unclassified aircraft guided-missile launcher and generator (valued at \$36,000) were delivered and reported to NAVICP, but NAVICP's internal files did not contain receipt information. In regard to one shipment, NAVICP officials explained that the Fleet and Industrial Supply Center in Norfolk, Virginia, reported that it had sent a shipment to the depot in San Diego, California, for storage. In actuality, the shipment had been sent to storage at the depot in Norfolk, Virginia. According to NAVICP officials, the Norfolk depot reported receiving the shipment; but NAVICP's in-transit inventory tracking system showed that the shipment had not been received. The officials could not explain why NAVICP's internal files did not contain receipt information on the second shipment.
- We were unable to review three shipments—one containing a classified aircraft guided-missile launcher and two containing unclassified alternating current generators—because the Navy could not provide us necessary documentary evidence. That information pertained to the

names of the shipments' commercial carriers, their mode of shipment, and their date of shipment.

The above examples demonstrate some of the procedural and system problems regarding in-transit inventory that have led to a lack of accountability. This lack of accountability could cause the inventory to become vulnerable to theft or loss and could cause managers to implement inefficient, ineffective decisions and practices regarding purchases that could lead to waste. NAVSUP and NAVICP officials acknowledged that it is possible that purchases could have been made as a result of items being written off.

While Navy officials are uncertain regarding whether purchases of inventory resulted from write-offs, our investigation showed that subsequent purchases may have been made for some of the sample items written off. We determined this by investigating 14 shipments that the Defense Distribution Depot in Norfolk, Virginia, had sent to repair facilities. For example, a commercial repair facility in Singapore received 3 shipments of 67 generators (valued at \$593,620). In fiscal year 1997, the inventory was written off as an in-transit loss. On October 12, 1999, NAVICP purchased 88 generators valued at \$13,625 each (\$1.2 million total) and, on October 22, 1999, initiated a purchase request for an additional 145 generators valued at \$13,000 each (\$1.9 million total). The generators are used in Navy aircraft.

In another example, 10 of the 14 shipments contained 11 cockpit video recorders (valued at \$56,650) that were sent to a commercial repair contractor in Santa Clara, California. Because of NAVICP's failure to adequately follow up on proof of shipment, delivery, or receipt with the appropriate facilities, the inventory was written off as an in-transit loss in fiscal year 1997. On September 30, 1997, NAVICP purchased 185 cockpit video recorders valued at \$5,398 each (\$998,630 total) and, on June 29, 1998, purchased 40 cockpit video recorders valued at \$6,850 each (\$274,000 total).

In order to determine if items were purchased as a result of inventory write-offs, additional work, such as an audit, would need to be conducted.

Shipments Later Accounted for by the Navy

During our previous review, NAVSUP officials contended that some items written off as lost had actually been received. However, they could not provide evidence to validate this contention. They explained that their information was based primarily on telephone calls and e-mail messages by the issuing facilities to intended recipients. During our investigation, we found that this information was primarily shipping information and not proof of either delivery or receipt. We reviewed 41 of the 45 shipments valued at \$226,834 that the Navy reported as accounted for and were able to determine that 38 shipments valued at \$222,044 had been delivered. However, we found that the shipments either had not been reported or had been reported inaccurately to NAVICP. The Navy could not provide us documentary evidence necessary to review the remaining three shipments.

- Twenty-five shipments containing a classified gyro assembly, a classified electronic control servo, and classified infrared turret windows (valued at \$129,350) were delivered to repair or storage facilities. Records show that the facilities did not accurately process shipping documents to indicate that they had received shipments. When the facilities reported the receipts to NAVICP, they did not cite the document numbers being used by NAVICP to track the shipments. For example, the Fleet and Industrial Supply Center in Norfolk, Virginia, sent a shipment to a commercial repair facility under document number N65886-6145-0FN3. However, the commercial repair facility reported the receipt to NAVICP under document number N65886-6145-1FN3. Because NAVICP's system was tracking the shipment under document number N65886-6145-0FN3, the system did not show that the items had been received; and the items were subsequently written off as lost.
- Eight shipments of classified aircraft guided-missile launchers (valued at \$83,684) were sent from the Fleet and Industrial Supply Center in Norfolk, Virginia, to the Army depot in Anniston, Alabama. Records show that the shipments were delivered to the Anniston depot. However, NAVICP officials explained that the depot was not required to acknowledge shipment receipts. A presumptive receipt program was supposed to close the records of outstanding shipments to the Anniston depot. However, NAVICP officials acknowledged that either they had failed to run the program or the program had failed to close the records; and the shipments were written off.
- Records showed that five shipments of classified nitrogen receiver assemblies (valued at \$9,010) were sent from the Fleet and Industrial Supply Center in Norfolk, Virginia, to the Defense Distribution Depot in San Diego, California. Upon delivery of the shipments, receiving

personnel signed for and processed them; but depot personnel were unable to provide evidence that the shipments were properly stored and that their receipts had been reported to NAVICP. In fiscal year 1997, the material was written off as an in-transit loss.

- We were unable to review three shipments—containing classified nitrogen receiver assemblies—because the Navy could not provide us necessary documentary evidence. That documentation pertained to the names of the shipments' commercial carriers, their mode of shipment, and their date of shipment.

Navy and DOD Efforts to Address In-Transit Inventory Deficiencies

In March 1999, we reported that the Navy was unable to account for over \$3 billion in in-transit inventory during fiscal years 1996 through 1998. In response, DOD stated that the Navy had taken steps to resolve internal control weaknesses identified in the March 1999 report. Among other things, the Commander, NAVSUP, (1) chartered an Integrated Process Team to review the current systems, policies, and processes to investigate material receipt acknowledgment problems and (2) proposed short-term solutions. NAVSUP officials explained that as part of this reengineering effort, they had determined that additional staff should be used to reconcile in-transit write-offs. They cite NAVICP efforts to avoid write-offs by tracking and investigating all shipment transactions over \$700,000 and over 45 days old. In July 1999, NAVSUP officials began documenting the results of their follow-up efforts. As of September 1999, they have resolved over 100 shipments valued at over \$136 million. Based on these results, NAVSUP has allocated \$1.7 million for additional staff to work on avoiding potential write-offs. It anticipates being able to decrease the level of review to below the current \$700,000 level. The additional funding is budgeted for 1 year.

In March 1999, NAVSUP issued policy guidance that requires follow-up and research on all shipments of classified and sensitive items prior to writing them off or reporting the items as lost. In addition, the revised procedures require that a list of all items that have reached the write-off time frame be forwarded to the Commander, NAVICP, for write-off approval. In September 1999, NAVSUP modified the Navy's in-transit tracking system to provide NAVICP (1) visibility, or tracking capability, over classified and sensitive in-transit items and (2) automated access to the files of issuing and receiving facilities for proof of shipment and receipt.⁷ NAVSUP officials explained that the Navy has initiated a new process in which the commanding officer of the last traceable holder of classified in-transit inventory will be held responsible for items that cannot be accounted for. Under the new process, the commanding officer is required to provide proof of either shipment or receipt. Otherwise, the officer must conduct a formal investigation to determine whether the unaccounted-for items are missing, lost, or stolen. It is too early to assess the impact of these initiatives.

Scope and Methodology

We conducted our investigation from July 1999 through October 1999 and began by reviewing our prior work. We then obtained shipment information from the Defense Distribution Depot, Fleet and Industrial Supply Center in Norfolk, Virginia, and NAVICP in Philadelphia, Pennsylvania. Using the information obtained, we selected shipments to investigate according to their location.

In addition to interviewing employees at the Defense Distribution Depot in Norfolk, we talked to Advanced Traceability and Control Hub employees to obtain proof of shipment information. We also visited depots in Anniston, Alabama; Letterkenney, Pennsylvania; and San Diego, California, to track down shipments and the Fleet and Industrial Supply Center in San Diego. We visited a commercial contractor in McKinney, Texas, and contacted commercial contractors in Santa Clara, California, and Singapore.

We met with NAVICP and NAVSUP officials to obtain an explanation of the Navy's write-off process and how it affects the financial and inventory accounts. On September 29, 1999, we discussed the results of our

⁷ These actions were in response to a GAO recommendation concerning further integration of the Navy's accounting and logistics systems. (See GAO/NSIAD-99-61, Mar. 31, 1999.) GAO has not assessed the effectiveness of these changes.

investigation with NAVSUP officials; and they agreed with our findings. NAVSUP officials also briefed us on the reengineering efforts being undertaken in response to our March 1999 report.

As arranged with your office, unless you announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Honorable William S. Cohen, Secretary of Defense; the Honorable Richard Danzig, Secretary of the Navy; Lieutenant General Henry T. Glisson, Director, Defense Logistics Agency; and the Honorable Jacob J. Lew, Director, Office of Management and Budget. We will also make copies available to others upon request. If you have questions concerning this report, please contact me on (202) 512-7455 or Assistant Director John Ryan on (202) 512-6722. Norman Burrell, Sandra Bell, and Kenneth Feng are key contributors to this case.



Robert H. Hast
Acting Assistant Comptroller General
for Special Investigations

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary, VISA and MasterCard credit cards are accepted, also.

Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (202) 512-6061, or TDD (202) 512-2537.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

<http://www.gao.gov>