

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

**BUDGETING FOR SECONDARY SUPPLY ITEMS IN THE
DEFENSE LOGISTICS AGENCY**

Report Number 92-043

February 10, 1992

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**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884**



February 10, 1992

MEMORANDUM FOR COMPTROLLER OF THE DEPARTMENT OF DEFENSE

SUBJECT: Report on the Audit of Budgeting for Secondary Supply
Items in the Defense Logistics Agency
(Report No. 92-043)

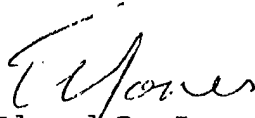
We are providing this final report for your information and use. The audit addresses the Defense Logistics Agency's use of sales data as the primary support for its FY 1992 and FY 1993 budget request for secondary items.

The Comptroller's office responded to our draft report on December 13, 1991; however, the comments were not responsive to the finding, recommendations, internal control weakness, or monetary benefits. DoD Directive 7650.3 requires that comments must indicate concurrence or nonconcurrence in the finding and each recommendation. If you concur, describe the corrective actions taken or planned, the completion dates for action already taken, and the estimated dates for completion of planned action. If you nonconcur, state your specific reasons for each nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements.

Potential monetary benefits of at least \$121.9 million have been identified. An additional \$68.6 million has been quantified for terminal items, that would be offset by an unquantified value for new inventory items. Therefore, we request your comments on the estimate of monetary benefits associated with the corrective actions. Any offsetting amounts related to new items entering the system should be identified in your response. Recommendations and potential monetary benefits are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. We also ask that your comments indicate concurrence or nonconcurrence with the internal control weakness highlighted in Part I.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, we request that you provide final comments on the recommendations and monetary benefits by April 10, 1992.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. James Koloshey at (703) 614-6225 (DSN 224-6225) or Mr. Stuart Dunnett at (703) 614-6222 (DSN 224-6222). The planned distribution of this report is listed in Appendix G.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:
Assistant Secretary of Defense (Production and Logistics)
Director, Defense Logistics Agency

Office of the Inspector General, DoD

AUDIT REPORT NO. 92-043
(Project No. OLA-0077)

February 10, 1992

BUDGETING FOR SECONDARY
SUPPLY ITEMS IN THE DEFENSE LOGISTICS AGENCY

EXECUTIVE SUMMARY

Introduction. As of March 31, 1990, the Defense Logistics Agency (DLA) managed approximately 926,000 replenishment line items, valued at \$12.5 billion, at five Defense supply centers. Headquarters, DLA, requested from Comptroller, DoD, obligational authority for FY 1992 and FY 1993 of \$3.7 billion and \$3.5 billion, respectively. DLA's budget request is used by the Comptroller, DoD, in the development of the President's Budget.

Objectives. The objectives of the audit were to:

- o ascertain whether DLA was adequately determining and accurately stating funding requirements for secondary items in its annual budget submission.

- o determine whether DLA was requesting sufficient funds to buy the materiel required to adequately support the Services.

- o evaluate implementation of the Federal Managers' Financial Integrity Act as it relates to budgeting for secondary supply items.

Audit Results. DLA's stock fund budget request for FY 1992 and FY 1993 was not a reliable estimate of future funding needs. The budget request was based primarily on prior sales, which alone may not be an accurate indicator of future requirements. Supporting documents necessary to reconcile budget data based on sales to line item stratifications (asset positions) were not prepared.

Internal Controls. We reviewed internal controls to ensure that the budget estimates represent valid funding requirements. The audit identified a material internal control weakness. Controls were not effective to ensure the accuracy and reliability of budget estimates provided to the Comptroller, DoD, by DLA. See the Finding in Part II for details on this weakness, and Part I for details of internal controls that we reviewed.

Potential Benefits of Audit. A one-time reduction in obligational authority of at least \$121.9 million to the Defense Stock Fund could be realized by eliminating funding authority for long supply (excess) in DLA's FY 1992 and FY 1993 Biennial Budget. An additional \$68.6 million in overstated material funding needs has been quantified for terminal items, that would be offset by an unquantified value for new items. The potential benefits of audit are summarized in Appendix E.

Summary of Recommendations. We recommended that DLA be required to develop budget estimates supported by line item stratifications, to eliminate long supply and terminal items from budget computations, and to prepare transition statements.

Management Comments. General comments to the draft report were received on December 13, 1991, from the Director for Revolving Funds, Comptroller, DoD. The Director responded that, due to inconsistencies between the budget submission request and amounts shown in our draft report, his office was unable to validate the finding, recommendations, internal control weakness, and monetary benefits addressed in the draft report.

Audit Response. After receiving the Director's response, we met with personnel from his office to clear up the "inconsistencies" and made appropriate changes to the report regarding our description of DLA's budget submission amounts. Part II of this report provides additional audit responses to the above comments made by the Director, as well as to other general comments he made concerning the draft report. In responding to our final report, we request that the Comptroller, DoD, provide specific comments indicating concurrence or nonconcurrence with the finding, each recommendation, internal control weakness, and the monetary benefits, as required by DoD Directive 7650.3, by April 10, 1992. Part IV contains the complete text of management's comments.

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This report was prepared by the Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 693-0340.

PART I - INTRODUCTION

Background

Budgeting for secondary supply items is a complex process involving the Defense Stock Fund; five of the Defense Logistics Agency (DLA) supply centers; Headquarters, DLA; and the Comptroller of the Department of Defense. Secondary supply items managed by DLA include consumable parts and supplies, such as electrical and industrial hardware, automotive and construction components, electronic equipment and spare parts, clothing and footwear, and medical supplies. As of March 31, 1990, these five DLA supply centers managed approximately 926,000 replenishment line items valued at \$12.5 billion. For the FY 1992 budget year, these five DLA supply centers submitted to Headquarters, DLA, a request for \$3.7 billion in total obligational authority. The final DLA budget submitted for approval to the Comptroller, DoD, requested \$4.5 billion in "total obligational authority" of which, \$.8 billion was related to "cost of operations" (Appendix A).

The DoD Budget Guidance Manual (DoD 7110-1-M) requires DLA to develop budgets for secondary items based on a line item budget stratification prepared in accordance with DoD Instruction 4140.24, "Requirements Priority and Asset Application for Secondary Items." According to the Instruction, the stratification process provides a means to uniformly portray secondary item funding requirements in preparation and support of budget submissions. The stratification also provides an initial estimate of funding requirements for the purchase of secondary items in a specific priority or time sequence.

Objectives

The primary objective of the audit was to determine whether DLA was adequately determining and accurately stating funding requirements for secondary supply items in its annual budget submission. Specifically, we determined whether DLA was requesting sufficient funds to buy the materiel required to adequately support the Services. We also reviewed the implementation of the Federal Managers' Financial Integrity Act as it relates to budgeting for secondary supply items.

Scope

Review of programs. We evaluated the policies and procedures used by the five DLA supply centers listed in Appendix A to formulate secondary item budgets. Our review concentrated on the individual budgets prepared and forwarded to

Headquarters, DLA, by each of the five supply centers from data obtained from their respective March 31, 1991, stratifications. Stratification data for fuel, subsistence, and numeric stockage objective items (insurance items retained for intermittent demands) were excluded from our review. We also reviewed DLA's proposed FY 1992 and FY 1993 Biennial Defense Stock Fund budget prepared independently by Headquarters, DLA, from financial records (sales data adjusted for inflation), and subsequently submitted to the Comptroller, DoD. Specifically, we evaluated the procedures and supporting documents for computing funding requirements and compared these procedures with budget guidance for the period covered by the FY 1992 and FY 1993 budget. We examined supply management policies related to maintaining other war reserve levels and evaluated the effect these levels had on funding requests and purchase decisions. We also evaluated the policies for DLA's inclusion of long supply (excess) and terminal (phasing out) items in its budget calculations. We used statistical sampling techniques for selecting terminal items for review.

Auditing standards. This economy and efficiency audit was made from July 1990 through April 1991 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. Activities visited or contacted during the audit are shown in Appendix F.

Internal Controls

The audit identified a material internal control deficiency as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Our review of budgeting procedures and related documentation showed that DLA did not have internal controls to ensure the accuracy of budget data for secondary items. As a result, budget estimates were overstated and could not be relied upon to predict future funding requirements. The recommendations in this report, if implemented, will correct the weakness. A copy of the final report will be provided to the senior officials responsible for internal controls within DoD and DLA.

Prior Audits and Other Reviews

Budgeting for Secondary Items - Military Departments. The Office of the Assistant Inspector General for Auditing issued Report No. 91-067, "Audit of Budgeting for Secondary Items in the Military Departments," March 20, 1991. The audit tested the accuracy of supply management data used to produce line item budget stratifications and evaluated adjustments that were used

to transition from the stratification output to the final budget request. The report identified potential overstatements totaling \$475.4 million resulting from data errors and unsupported adjustments of \$69.4 million on the final budget request. The audit recommendations were to strengthen and expand controls over line item data verification and the budget adjustment process. Management agreed to implement the recommended improvements to the budget process.

Budgeting for War Reserves - Defense Logistics Agency. The Office of the Assistant Inspector General for Auditing issued Report No. 91-056, "Quick-Reaction Report on Budgeting for War Reserve Stocks in the Defense Logistics Agency," on March 4, 1991. This quick-reaction report was issued as a result of FY 1990 and FY 1991 budget overstatements requiring immediate action. This report also addressed the adequacy and accuracy of funding requirements. At five DLA supply centers, DLA was improperly protecting \$1.26 billion of other war reserve stock and including those levels as mobilization requirements in developing its budget estimates for secondary supply items. The report recommended that the Comptroller, DoD, in coordination with the Assistant Secretary of Defense (Production and Logistics), issue budget guidance requiring DLA to recompute funding needs based on the application of on hand other war reserve protected stocks against peacetime operating requirements. It also recommended that the Comptroller reduce obligational authority by an appropriate amount for the deficiencies that could be satisfied by the protected stock. The report further recommended that the Director, DLA, curtail ongoing procurement actions to reflect removal of other war reserve requirements included in reorder computations and to take immediate action to adjust other war reserve materiel requirement levels that are used in budget and procurement computations, when the using Services' most recent statements of requirements do not support those levels. As a result of the mediation process, management is taking corrective action to implement all recommendations.

Other Matters of Interest

From April 1, 1989, to March 31, 1990, DLA invested \$413.3 million in stock fund money to support other war reserve levels without any assurance that the resulting asset position would meet readiness goals of DoD. DoD policy for funding war reserve stock specifies that DoD Components should identify items that qualify for war reserve consideration. Once identified, these items should then be evaluated to determine the most critical items so that limited resources would not be expended to purchase noncritical items. As discussed in the IG, DoD, Report No. 91-056, DLA's system of creating protected war reserve levels

from long supply assets bypassed the evaluation process; thus, the system did not ensure that the resulting items met high priority war reserve requirements.

For example, we reviewed the requirements for National Stock Number (NSN) 5306-00-227-0582, a machine bolt. As of March 31, 1990, DLA was maintaining a protected war reserve quantity of 2,742 machine bolts valued at \$4,168. In our opinion, maintaining war reserve levels for common, low dollar value items like this bolt is inconsistent with DoD policy for funding war reserves. A sampling of items for which DLA was maintaining war reserve levels is included at Appendix B. We are not making a recommendation on this issue because the process of selecting items for war reserves is outside the scope of our audit; however, there is a need for revalidation of items in the other war reserve category.

PART II - FINDING AND RECOMMENDATIONS

DLA BUDGETING PROCEDURES

The DLA stock fund budget request for FY 1992 and FY 1993 was not a reliable estimate for future funding requirements. This condition occurred because DLA inappropriately used sales data as the primary basis for funding requests rather than using comparisons of forecasted requirements and available assets to determine expected procurements. As a result, the FY 1992 and FY 1993 budget request submitted to the Office of the Secretary of Defense contained unreliable data and overstated material funding needs by at least \$121.9 million for items in long supply. An additional \$68.6 million in overstated material funding needs has been quantified for terminal items, that would be offset by an unquantified value for new items.

DISCUSSION OF DETAILS

Background

DoD Manual 7110-1 provides that stock fund budgets shall be computed in the same manner as procurement appropriation budgets. The guidance specifies that in developing funding requirements for the purchase of new stocks to offset consumption of old stocks, all assets will be applied against gross requirements in computing net funding needs. The process of basing secondary item budgets on analyses of requirements and available assets, in accordance with budget guidance, provides detailed support for funding requests. Budgets prepared in this manner provide a plan for using the allocated funds for secondary item purchases. The Military Departments used this method of budgeting for secondary items.

Sales Based Budgeting

DLA's budget request improperly used sales as a basis for future requirements. Furthermore, budget documents were not supported by adequate analysis of inventory requirements and asset position.

Sales data. DLA used sales data as the basis for funding requests rather than comparisons of forecasted asset requirements and available assets to determine procurement needs. This procedure does not adequately relate sales to asset position and assumes that all assets sold will be replaced on a one for one basis. Sales data alone are not a reliable estimate of future procurement needs, because sales can occur for items that are in long supply and for items that are not authorized for future purchase (terminal items) and also do not reflect new items with little or no sales history.

Long supply items. DLA's FY 1992 and FY 1993 budget submission overview states, in part, ". . . with the exception of clothing, this budget assumes full replacement of net sales in FY 1991, FY 1992, and FY 1993." We do not agree with this assumption because sales of supplies from earlier stocks do not always necessitate procurements during the budget period. The five DLA supply centers submitted data tapes containing 925,797 line items from the March 31, 1990, budget stratification. We determined that there were 204,785 separate line items with excess stock (long supply) on hand valued at \$680.1 million. During the four quarters preceding the stratification, line items with excess stock had experienced sales valued at \$77.6 million. Using DLA's method of estimating budgets from sales data, we estimated that FY 1992 and FY 1993 budgets were overstated by \$62.9 million and \$59.0 million, respectively, as a result of including sales of excess items in the sales baseline as shown in Appendix C. Because DLA uses sales as the primary determinant of funding needs, sales of long supply items would inappropriately increase its budget request. In our opinion, DLA inventory managers will not purchase replacements for long supply items. Accordingly, sales of these items should be removed from funding requirements.

Terminal items. DLA manages items for which future procurements are not authorized. These items are identified on supply center records as terminal items. There are two types of terminal items: those where terminal items are being replaced by similar items and those where items are being phased out of the DoD inventory without replacement or substitution.

The March 31, 1990, stratification tapes showed that 29,537 terminal items had demands valued at \$115.1 million during the previous four quarters. DLA had no procedures to eliminate budget requirements for these terminal items. Using the stratified random sampling plan (see Appendix D), we selected a sample of terminal items from the stratification data tapes to determine the quantity and value of terminal items without replacement. We estimated that terminal items without replacement had sales valued at \$43.7 million during FY 1989. Using DLA's method of estimating funding requirements from sales data, we estimated that FY 1992 and FY 1993 budgets were overstated by \$35.4 million and \$33.2 million, respectively, because sales of these terminal items were included in the baseline sales data (see Appendix C).

Transition statements. Defense budget guidance specifically requires the preparation of transition statements for procurement appropriation budgets but does not mention the need for one in preparing stock fund budgets. Thus, DLA did not prepare transition statements for its stock fund budget. In contrast,

the Military Departments prepared transition statements for both procurement budgets and stock fund budgets. Transition statements provide the link, by means of adjustments, between the budget and supporting stratification data. The Military Departments used transition statements to remove requirement levels pertaining to terminal items and to add requirements for new items that were not included in budget data. Military Department transition statements also provided detailed analyses of budget data and disclosed the effect of significant assumptions used in budget development, such as assumptions regarding force down-sizing.

DLA's budget document, "Defense Stock Fund, General Narrative Justification," (SF-2 and supporting exhibits) did not clearly show to what extent sales based budgets differed from line item stratification projections. Additionally, asset positions were not adequately considered in deriving the data shown on these documents. Similarly, the budget documents neither disclosed that long supply and terminal items were included in the computation of funding needs nor indicated the extent to which new items would increase inventory needs. In our opinion, transition statements detailing the effect of significant supply management policies should be prepared to support budget requests.

Conclusion

Controls over the budgeting process need to be strengthened to avoid overestimating funding needs and overstating inventory requirements that could lead to inventory growth. The growth of inapplicable inventories in recent years and DoD initiatives to reduce those inventories place renewed emphasis on the role of budgeting in controlling expenditures. To reduce inapplicable inventories, DLA should budget on the basis of using existing stocks to satisfy customer needs and avoiding new procurements. DLA maintains supply management data that should be used to formulate budgets and to plan for using existing assets more effectively. We recognize that determining inventory requirements is a complex process; however, DLA has sufficient data to allow for meaningful analyses and to improve secondary item budgets.

RECOMMENDATIONS, MANAGEMENT COMMENTS, AND AUDIT RESPONSE

We recommend that the Comptroller, Department of Defense, issue budget guidance that requires the Defense Logistics Agency to:

1. Discontinue the practice of using sales data as the primary determinant of the amount of funding requests. Asset position, as determined by the stratification process, should be considered when developing funding requests.

2. Remove from budget requirements long supply and terminal items that will not be purchased during budget periods.

3. Identify demands and requirements for new items entering the supply system and increase funding requests, as appropriate, to accommodate new requirements.

4. Prepare transition statements for stock fund budgets to support budget requests, to document and explain budget adjustments, and to disclose significant assumptions used in budget formulation.

Comptroller, DoD, comments. General comments to the draft report were received on December 13, 1991. The Director of Revolving Funds (Director) stated that, due to inconsistencies in DLA's budget submission requests, his office was unable to validate the finding, recommendations, internal control weakness, and monetary benefits addressed in the draft report.

In addition, the Director provided the following general comments.

- The draft report does not address whether or to what extent the FY 1992/1993 DLA budget considered the application of assets.

- The draft report seems to assume that obligation requirements are based directly on sales or that the amount of sales directly generates the obligations. He further stated that many other factors are considered in obligation determination and for the current time obligational authority has been less than the sales value.

- The use of sales forecast is a better budgeting tool for forecasting requirements than a stratification based value. Stratification is based on experienced demand In periods where the scope of defense programs is changing, experienced demand is of less value in determining future requirements.

Audit response. After our meeting with personnel from the Director's office, we were able to attribute the inconsistencies referred to in the Director's response to differences between figures provided to us by DLA that represented its FY 1992 and FY 1993 total obligational target requests for secondary items and the adjusted figures provided to the Comptroller, DoD, by DLA that broke out separately the Defense Stock Fund's "cost of operations" charge. The Comptroller, DoD, had requested DLA to separate this charge from its total obligational target amount, to provide only the "material" obligational target amount.

We have revised the total obligational target amount for secondary items referenced in our draft report (Appendix A) to include the reduction related to "cost of operations" expenses in arriving at the bottom line "material" cost. We have also removed the applicable "cost of operations" amount from our budget overstatement computation related to long supply and terminal items (Appendix C).

The following comments are provided in response to the Director's general comments concerning the draft report.

- As stated in the draft report, DLA's budget request used sales data only, derived from its financial records, as a basis for its proposed budget request. DLA did not consider the application of assets in preparing the budget request submitted to the Comptroller, DoD, nor did DLA provide a transition statement to relate sales to asset position.

- We realize that the Comptroller, DoD, takes into consideration other factors in determining obligation authority. However, DLA's budget considered only sales as the primary basis in preparing its funding request rather than also using comparisons of forecasted requirements and available assets to determine expected procurements.

- We did not recommend that "experienced demand", as determined from the stratification process, be used in determining future requirements. Rather we recommended that "asset position", as determined by the stratification process, be considered when developing funding requests.

Therefore, in his response to the final report, we request that the Comptroller, DoD, provide specific comments on the finding, recommendations, internal control weakness, and monetary benefits.

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PART III - ADDITIONAL INFORMATION

- APPENDIX A - Defense Logistics Agency Inventory Values
as of March 31, 1990, Stratification, and
FY 1992 and FY 1993 Funding Requests
- APPENDIX B - Examples of Defense Logistics Agency War
Reserve Items as of March 1990
Stratification
- APPENDIX C - Computation of Budget Overstatements
Related to the Sales of Long Supply and
Terminal Items
- APPENDIX D - Statistical Sampling Plan and Results
- APPENDIX E - Summary of Potential Benefits Resulting
from Audit
- APPENDIX F - Activities Visited or Contacted
- APPENDIX G - Report Distribution

APPENDIX A: DEFENSE LOGISTICS AGENCY INVENTORY VALUES AS OF MARCH 31, 1990, STRATIFICATION, AND FY 1992 AND FY 1993 FUNDING REQUESTS

<u>Defense Supply Centers</u>	Inventory as of March 31, 1990 ^{1/}		Obligation FY 1992 ^{2/}	Targets FY 1993 ^{2/}
	<u>Line Items</u> (Thousands)	<u>Value</u> (Millions)	<u>Value</u> (Millions)	<u>Value</u> (Millions)
General, Richmond, VA	154.5	\$ 2,043.0	\$ 784.0	\$ 746.6
Industrial, Philadelphia, PA	309.2	1,695.0	702.3	681.0
Construction, Columbus, OH	160.0	1,598.0	843.3	806.3
Electronics, Dayton, OH	255.5	1,841.0	619.7	595.6
Personnel, Philadelphia, PA:				
Clothing and Textiles	22.3	4,301.0	822.5	809.9
Medical	<u>24.3</u>	<u>1,066.0</u>	<u>687.0</u>	<u>720.0</u>
Totals in DLA Submissions	<u>925.8</u>	<u>\$ 12,544.0</u>	<u>\$4,458.8</u>	<u>\$4,359.4</u>
Cost of Operations			(763.9)	(814.2)
Material Cost			<u>\$3,694.9</u>	<u>\$3,545.2</u>

^{1/} Amounts shown exclude fuel, subsistence, and numeric stockage objective inventory items.

^{2/} Per Defense Logistics Agency, Defense Stock Fund FY 1992/FY 1993 Biennial Budget Estimates, dated September 17, 1990

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APPENDIX B: EXAMPLES OF DEFENSE LOGISTICS AGENCY WAR RESERVE ITEMS AS OF MARCH 1990 STRATIFICATION

<u>Item Name</u>	<u>Protected Level * Reserve</u>	<u>Value</u>
Incandescent Lamp	423	\$ 989.82
Wood Screw	126	5.04
Electric Hot Plate	30	2,310.00
Fuse Cartridge	220	336.60
Vehicle Cushion Seat	3	260.70
Drill Chuck Key	809	364.05
Drawing Board	5	68.55
Vegetable Slicer	12	1,160.16
Plain Hexagon Nut	26	52.00
Machine Screw	100	211.00
Electrical Wire	9,919	2,380.56
Screw Bolt	2,742	4,167.84
Circuit Breaker	66	3,420.78
Swivel Caster	6	372.00
Push Switch	35	1,673.35
Voltmeter	11	1,903.00
Machine Bolt	8,434	1,433.78

* Various units of issue

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APPENDIX C: COMPUTATION OF BUDGET OVERSTATEMENTS RELATED TO THE SALES OF LONG SUPPLY AND TERMINAL ITEMS

DLA estimates future sales by making adjustments to current period data. These adjustments are intended to account for general price changes (inflation/deflation), expected declines in customer orders, surcharge adjustments, and special programs, if applicable. The table below displays the net percentage impact of all sales adjustments at the five DLA supply centers, excluding fuel and subsistence, applied to sales of long supply and terminal items.

Description	(1)	(2)	(3)	(4)	(5)	(6)
	FY 1990 Baseline Sales (Value) (Millions)	FY 1992 Budget Adjustment Factor <u>1/</u> (Percent)	Total <u>2/</u> (Value) (Millions)	FY 1993 Budget Adjustment Factor <u>1/</u> (Percent)	Total <u>3/</u> (Value) (Millions)	FY 1992 and FY 1993 Impact <u>4/</u> (Value) (Millions)
Sales of Items in Long Supply	\$77.6	.81	\$62.9	.76	\$59.0	\$121.9
Sales of Items Terminated Without Replacement	\$43.7	.81	\$35.4	.76	\$33.2	<u>68.6</u>
Total						<u>\$190.5</u>

1/ Adjustment due to percentage general asset price changes (net of cost of operations)

2/ Cumulative effect resulting from applying FY 1992 adjustment factors (Column 2) to FY 1990 baseline sales (Column 1)

3/ Cumulative effect resulting from applying FY 1993 adjustment factors (Column 4) to FY 1990 baseline sales (Column 1)

4/ Total of Column (3) and Column (5)

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APPENDIX D: STATISTICAL SAMPLING PLAN AND RESULTS

DLA provided data tapes containing output from the March 31, 1990, stratification for each of the DLA supply centers. These data tapes contained line item data for 925,797 replenishment items, of which 29,537 were terminal items that had demands valued at \$115.1 million during 1989. We used a stratified random sampling plan to select a sample of 154 items having demands valued at \$32.0 million. A breakdown of universe and sample size for each dollar value stratum is included below.

We projected the sample results with a confidence level of 95 percent and a relative sampling precision of ± 63 percent for attributes and ± 26 percent for dollars. Based on the results of our review of the March 31, 1990, stratification, we estimated that 4,492 items with demands valued at \$43.7 million were terminated without replacement.

Sampling Plan and Results

Stratum	Universe		Sample		Projections	
	Items	Value (000s)	Items	Value (000s)	Items	Value (000s)
Over \$1,000	9	\$ 13,992	9	\$13,992	1	\$ 2,672
\$300 to \$1,000	48	25,832	25	12,913	4	1,603
\$ 50 to \$ 300	335	37,379	40	4,382	184	17,824
\$ 5 to \$ 50	1,759	26,703	40	713	880	16,185
Under \$ 5	27,386	11,207	40	16	3,423	5,429
Total	<u>29,537</u>	<u>\$115,113</u>	<u>154</u>	<u>\$32,016</u>	<u>4,492</u> ^{1/}	<u>\$43,713</u> ^{2/}

^{1/} Number of items terminated without replacement (95% confidence)
4,492 \pm 2,830 items

^{2/} Value of demands for items terminated without replacement (95% confidence)
\$43,713 \pm \$11,365 (thousands).

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APPENDIX E: SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

<u>Recommendation Reference</u>	<u>Description of Benefits</u>	<u>Amount and/or Type of Benefit</u>
1., 3., and 4.	<u>Internal Control.</u> Provide better assurance for accountability of supply items that had a direct effect on funding needs, for an audit trail to ensure the reliability and accuracy of the budget estimates.	<u>Nonmonetary.</u>
2.	<u>Economy and Efficiency.</u> To provide more accurate budgetary input in order to improve the efficiency and effectiveness of the budgeting process of the Defense Stock Fund.	<u>Monetary.</u> Funds put to better use of at least \$121.9 million. An additional \$68.6 million in quantified funds would be offset by an unquantified value for new inventory items. This is a one-time reduction in obligation authority to the Defense Stock Fund.

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APPENDIX F: ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Secretary of Defense, Washington, DC
Office of the Comptroller of the Department of Defense, Washington, DC
Office of the Assistant Secretary of Defense (Production and Logistics), Washington, DC

Defense Activities

Headquarters, Defense Logistics Agency, Cameron Station, VA
Defense Logistics Agency - Subordinate Activities:
Defense General Supply Center, Richmond, VA
Defense Industrial Supply Center, Philadelphia, PA
Defense Construction Supply Center, Columbus, OH
Defense Electronics Supply Center, Dayton, OH
Defense Personnel Support Center, Philadelphia, PA

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APPENDIX G: REPORT DISTRIBUTION

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics)
Assistant Secretary of Defense (Public Affairs)
Comptroller of the Department of Defense

Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, U.S. Army Audit Agency

Department of the Navy

Auditor General, Naval Audit Service

Department of the Air Force

Air Force Audit Agency

Non-DoD Activities

Office of Management and Budget
National Security Division, Special Projects Branch
U.S. General Accounting Office
NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Ranking Minority Member, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security,
Committee on Government Operations

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PART IV - MANAGEMENT COMMENTS

Comptroller of the Department of Defense

COMMENTS OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

(Program/Budget)

December 10, 1991

MEMORANDUM FOR DIRECTOR, LOGISTICS SUPPORT DIVISION, DOD IG

SUBJECT: Report on the Audit of Budgeting for Secondary
Supply Items in the Defense Logistics Agency
(Project No. DLA-0077)

This provides the response to your draft audit forwarded by memorandum of September 30.

The draft audit is based on the premise that DLA submitted overstated budget submissions in FY 1992 and FY 1993 as a result of not following prescribed budget preparation techniques. An analysis of budget data indicates that the DLA submissions are significantly less than stated in the report and that requirements were understated rather than overstated by \$242.8 million as indicated in the audit. The following table is provided for information:

	<u>(Dollars in Millions)</u>	
	<u>FY 1992</u>	<u>FY 1993</u>
FY 1992/1993 Material Budget		
DoD IG - DLA Request	4,458.8	4,359.4
DLA Request received at OSD	3,694.9	3,545.2
DoD Budget to Congress	3,660.6	3,462.7

This office was unable to validate the findings, recommendations, internal control weaknesses, and monetary benefits in the draft audit because of the inconsistencies in the DLA budget submission requests. The following comments are provided:

The audit asserts that budgets based on prior sales may not be an accurate indicator of future requirements. It states that reconciliation to stratification and consideration of asset position is required and that sales of long supply and terminal items, both of which do not require reprourement, overstates obligation requirements by up to \$242.8 million. It does not address whether or to what extent the FY 1992/1993 DLA budget considered the application of assets.

The draft audit seems to assume that obligation requirements are based directly on sales or that the amount of sales directly generates the obligations. Many other factors are considered in obligation determination. DoD has implemented a funding technique under unit cost principles that bases obligational authority on a relationship to sales that for the current time is less than one. Congress has legislated such a relationship in both FY 1991 and FY 1992.

The use of sales as a budgeting tool allows adjustment of sales forecasts to account for known variations in the programs to be supported. Stratification is based on experienced demand and known special programs. In periods where the scope of defense programs is changing, experienced demand is of less value in determining future requirements.

We appreciate this opportunity to comment. Please let us know if we can be of any additional help.



William C. Coonce
Director for Revolving Funds

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