



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

REPORT
No. 92-033

January 10, 1992

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Quick-Reaction Report on the Defense Logistics Agency's
Adjustment of Wholesale Inventory Levels After
Operation Desert Storm (Project No. 1LE-5003.02)

Introduction

As part of the overall objectives for the Audit of Requisitions in Support of Operation Desert Storm (Project No. 1LE-5003), we evaluated the effect of Operation Desert Shield/Storm (ODS) requisitions on the DoD wholesale supply system's inventory requirements. We reviewed the policies and practices followed by the Defense Logistics Agency's supply centers to adjust inventory requirements and return to a peacetime logistics posture after hostilities ended. The supply centers took various actions in an attempt to minimize the effect of ODS demands on forecasted requirements and initiated large cutbacks in previously approved purchases after ODS. However, our review of 57 items with \$52.2 million of procurements in process, as of July 1991, indicated that purchases of about \$19.2 million for 18 of the items were excessive to forecasted peacetime requirements. Additional action was needed because not all stock levels were adequately adjusted to exclude ODS demands that were not representative of peacetime requirements and thus allow inventories to deflate to levels appropriate to supporting peacetime operating forces.

Background

The Defense Logistics Agency (DLA) has four supply centers that manage spare and repair parts. The centers procure spare and repair parts based on forecasted requirements generated by the Standard Automated Materiel Management System (SAMMS). One of the primary factors used by the SAMMS to forecast future requirements and to compute inventory stockage objectives is the quarterly forecast demand (QFD). The QFD for an item usually represents a smoothed average (continually adjusted, monthly or quarterly) of historical demands.

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Requisitions (demands) for some DLA managed materiel during ODS were appreciably greater than those experienced during peacetime. The DLA Headquarters recognized that failure of the supply centers to adjust system-computed QFDs after ODS to eliminate the effect of ODS requisitions could result in the acquisition of materiel that would be excess to future requirements. Accordingly, in March 1991, DLA directed the supply centers to adjust the historical demand bases to exclude ODS experience.

To evaluate the effectiveness of adjustments made to demand bases to exclude ODS experience, we judgmentally selected for review 57 items being purchased at three of the supply centers (the Defense Construction Supply Center, the Defense Electronics Supply Center, and the Defense General Supply Center). We recalculated the forecasted requirements for those items using demand bases that did not include ODS demands and compared the requirements to the items' asset position, using safety levels and procurement lead times as of July 1991. A list of activities visited is in Enclosure 4.

Discussion

Although the DLA supply centers took aggressive actions to reduce procurements after ODS hostilities ended, significant quantities of materiel that were being procured by the centers were excessive to peacetime needs and could result in unnecessary or premature investments in inventory. We attributed the excessive procurements to a lack of specific guidance to and oversight of the supply centers on how to adjust stock levels to minimize the effect of ODS demands on requirements forecasts and untimely action to reduce or cancel excessive on order quantities when requirements forecasts were adjusted to remove ODS demands from the forecasts.

Demand Base Adjustments. When the demand base period used in the development of a requirements forecast includes demands for ODS that are not representative of what may be expected to support peacetime operating forces, the QFD and the computed stockage objective may be significantly overstated and could result in premature or unnecessary purchases of inventory. For 15 of the 57 items reviewed, procurements of materiel valued at \$17.6 million were excessive primarily because the QFDs on which the purchases were predicated were influenced by base periods that included substantial ODS demands (see Enclosure 1). In the absence of specific guidance, each of the three DLA supply centers included in our review adopted a different approach in adjusting its requirements' system demand bases to discount for the effect of ODS demands on forecasted requirements. The results of our review of actions taken by each of the supply centers are presented in the following paragraphs.

Defense Construction Supply Center (DCSC). In April 1991, DCSC item managers were instructed to compare the December 1990 QFD to the March 1991 QFD and to use the lower of the QFDs to compute forecasted requirements. In May 1991, the item managers were instructed to compare the April 1991 QFD to the previously used QFD and use the lower of the QFDs to calculate future requirements. This approach did not adequately compensate for the adverse effect of ODS demands on the requirements' forecasts because each of the QFDs used in the comparisons included demands in the peak ODS demand months of August 1990 through February 1991. Accordingly, the ODS demands influenced the forecasted peacetime requirements. To illustrate, in July 1991, an item manager was procuring 403,841 rolls of barbed tape, national stock number (NSN) 5660-00-921-5516, valued at \$11.7 million, based on a QFD of 42,983 rolls. We recomputed requirements for this item using the pre-ODS QFD and also a demand base consisting of the latest four quarters of peacetime demand experience (that is, excluding the ODS demand quarters--July 1990 through March 1991). Had the item's pre-ODS QFD of 29,838 rolls been used to compute requirements, procurement for this item could have been reduced by 341,864 rolls valued at \$9.9 million. Had the item's average demand for the four peacetime quarters before July 1991 been used to compute requirements, procurement for this item could have been reduced by 371,184 rolls valued at \$10.8 million.

Defense Electronics Supply Center (DESC). In April 1991, DESC item managers were instructed to review the requirements for any item for which during the last two quarters (October 1990 through March 1991): overall demands increased by more than 25 percent, ODS demands accounted for more than 10 percent of demand, or the total dollar value of ODS demands exceeded \$500. Specific adjustment instructions were not provided to the item managers, but item managers were advised, ". . . the intent of this review is to return NSNs to pre-ODS support levels." Appropriate adjustments were not always made to forecasted requirements. For example, one item manager was procuring 18,311 electromagnetic relays (NSN 5945-00-435-1833) valued at \$342,049, to support requirements that were based on a QFD of 2,451 relays. Had the item's QFD before ODS been used, the procurement for this item could have been reduced by 15,590 relays valued at \$291,221. Had the item's average demand in the four peacetime quarters before July 1991 been used, the purchase of this item could have been reduced by 14,842 relays valued at \$277,248.

Defense General Supply Center (DGSC). In April 1991, DGSC item managers were directed to use the pre-ODS QFD (specifically, the June 1990 QFD) to determine future

requirements. This approach was the most conservative of the three supply centers. Our review of 23 items at DGSC indicated that the Center's item managers had used pre-ODS QFDs, therefore, their requirements forecasts after ODS were likely to reflect requirements that could reasonably be anticipated in a peacetime operating environment.

Not all items managed by the DLA supply centers were affected by ODS demands, but those demands were appreciable for a number of items. According to statistics accumulated by DLA Headquarters as of March 1, 1991, the approximate scope of ODS demands for the four DLA hardware supply centers was:

<u>Center</u>	<u>ODS Requisitions</u>		<u>Number of Affected NSNs (000)</u>
	<u>Number (000)</u>	<u>Value (\$ millions)</u>	
Construction	432	\$283	68
Electronics	225	57	53
General	288	374	40
Industrial	526	99	97
Total	1,471	\$813	258

Due to limitations of the DLA system's (SAMMS) historical data base, we could not readily identify all of the items and inventory levels that were influenced by ODS demands. However, a comparison of data available at the DCSC and DESC indicated that ODS demands made up a large part of the total demands for some items in the ODS period. For example in our sample items, ODS requisitions for nine DCSC items represented 40 percent or more of the total demands and for six DESC items, ODS represented 23 percent or more of the total demands.

Cancellation of Excessive On Order Quantities. For 3 of the 57 items reviewed, prompt action was not taken to reduce or cancel excessive on order quantities even though the QFDs and stockage levels were reduced to pre-ODS levels. Adjustments to the stockage levels for the three items indicated that purchases of materiel valued at \$1.6 million should have been curtailed. This report does not include a recommendation on this condition because it was previously reported to DLA in IG, DoD, Report No. 91-037, "Defense Logistics Agency Requirements for Currently Procured Wholesale Inventories," January 30, 1991. Furthermore, we will evaluate whether DoD wholesale inventory management activities adequately curtailed procurements in response to reduced requirements in IG, DoD, "Audit of Adjustments to Wholesale Spare and Repair Parts Inventories After Operation Desert Storm," Project No. 1LE-0067, announced on July 31, 1991.

Summary

The DLA supply centers were continuing to procure wholesale stock of items affected by ODS demands. Because the investment in these items can be substantial, the appropriateness and promptness of adjustments made to compensate for the effect of ODS requisitions on forecasted peacetime requirements is important to minimize wholesale inventory investments.

Recommendations for Corrective Action

We recommend that the Director, Defense Logistics Agency:

1. Establish specific guidance on the elimination of ODS demands from the computation of forecasted peacetime requirements and require feedback from the supply centers on the implementation of the guidance.

2. Direct the supply centers to recalculate forecasted requirements for items affected by ODS demands, using the new guidance, and reduce or cancel excessive quantities of supply being procured, if economical.

Management Comments

The Deputy Comptroller, Defense Logistics Agency, responded to our draft quick-reaction report on December 20, 1991. The Deputy Comptroller partially concurred with the finding and recommendations. She stated that the general problem described in the report existed at only one DLA center and only isolated examples were found at one other center. However, the DLA has agreed to restate and clarify its guidance on elimination of ODS demands and require implementation feedback. The guidance will also restate the need to reduce or cancel excessive quantities. The Deputy Comptroller concurred with \$14.6 million of the \$19.2 million potential quantifiable monetary benefits (Enclosure 3) after reducing the estimate for one purchase request valued at \$4.6 million that was required to maintain the industrial base. The complete text of the DLA's response is in Enclosure 2.


Audit Response

We do not share DLA's opinion that the condition existed at only one center. The draft report provided information that showed the condition occurred at two of the three centers we reviewed. The examples at the Defense Electronics Supply Center did not have as much monetary significance but they were no more isolated than, and were attributable to the same causes as, those at the Defense Construction Supply Center.

Even though DLA stated that it partially concurred with the recommendations, we consider its reply as a concurrence because the actions to be taken are responsive to our recommendations.

DoD Directive 7650.3 requires that all audit recommendations and potential monetary benefits be resolved promptly. Therefore, we request that DLA provide copies of its clarifying guidance for Recommendations 1. and 2. and justification for the \$4.6 million industrial base requirement in its response to the final report. We also request that DLA provide us the amount of reductions and cancellations taken in response to Recommendation 2., for items not in our sample. Final comments should be provided by January 27, 1992.

The courtesies and cooperation extended to the audit staff are appreciated. If you have any questions regarding this quick-reaction report, please contact Mr. James Helfrich, Program Director, or Mr. John Issel, Project Manager, at (614) 238-4141 (DSN 850-4141). Audit team members are listed in Enclosure 5. Copies of the final report are being distributed to the activities shown in Enclosure 6.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

ITEMS WITH EXCESS PROCUREMENTS
USING VARIOUS DEMAND BASES

National Stock Number	Forecast Demand Basis for		Quantity Peacetime		Purchases in Process		Excessive Purchases Based On	
	Buy	Pre-ODS	Quarter Average	Qty.	Value	Qty.	Value	Quarter Average Value
<u>Defense Construction Supply Center</u>								
4520-00-540-0557	326	171	102	3,778	\$ 2,549,167	2,364	\$ 1,595,085	2,788 \$ 1,881,175 *
2590-00-121-8990	63	9	11	587	3,236,095	556	3,065,194	546 3,010,065
2815-01-132-7298	40	28	14.8	218	214,416	96	94,421	154 151,468
2910-00-884-1207	646	357	351	2,275	80,353	1,003	35,425	1,018 35,955
5660-00-270-1589	29,918	23,085	16,777	119,769	300,620	110,991	278,587	119,769 300,620
4720-00-083-0044	675	66	64	1,252	227,601	293	53,264	296 53,809
5660-00-270-1587	44,668	15,810	18,720	8,659	35,761	8,659	35,761	8,659 35,761
4610-00-268-9890	1,362	742	698	9,063	1,111,033	5,308	650,707	5,460 669,341
5660-00-921-5516	42,983	29,838	21,761	403,841	11,743,696	341,864	9,941,405	371,184 10,794,031
<u>Defense Electronics Supply Center</u>								
5985-00-470-1374	26	9	9.5	187	191,994	96	98,564	94 96,510
5945-00-435-1833	2,451	1,599	1,724	18,311	342,049	15,590	291,221	14,842 277,248
5820-00-782-8896	105	39	46	201	133,906	201	133,906	201 133,906
5960-00-679-1791	15	12	8.5	72	71,949	40	39,972	48 47,966
7035-01-222-1484	54	14	41	190	376,722	190	376,722	62 122,930
5920-00-471-2548	1,035	401	541	1,459	1,269	1,459	1,269	1,459 1,269
Totals					\$20,616,631		\$16,691,503	\$17,612,054

* After our review, \$1.5 million in procurements was cancelled.

MANAGEMENT COMMENTS: DEFENSE LOGISTICS AGENCY



DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100



IN REPLY
REFER TO DLA-CI

20 DEC 1991

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: DoD IG Quick Reaction Draft Report on the DLA
Adjustment of Wholesale Inventory Levels After
Operation Desert Storm, (Project No. 1LE-5003.02)

Enclosed are our comments to the subject report finding. These were omitted from our 6 December response which addressed only the recommendations. The attached positions have been approved by Ms. Helen T. McCoy, Deputy Comptroller, Defense Logistics Agency.

3 Encl

Jacqueline G. Bryant
JACQUELINE G. BRYANT
Chief, Internal Review Division
Office of Comptroller

ENCLOSURE 2
PAGE 1 OF 8

MANAGEMENT COMMENTS: DEFENSE LOGISTICS AGENCY (Cont'd)

FORMAT 1 OF 3

TYPE OF REPORT: AUDIT

DATE OF POSITION: 19 Dec 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND *: Draft Quick Reaction Report on the Defense Logistics Agency's Adjustment of Wholesale Inventory Levels After Operation Desert Storm (Project No. 1LE-5003.02)

FINDING: Although the DLA supply centers took aggressive actions to reduce procurements after ODS hostilities ended, significant quantities of materiel that were being procured by the centers were excessive to peacetime needs and could result in unnecessary or premature investments in inventory.

The DLA supply centers are procuring and will continue to procure wholesale stock of items affected by ODS demands. Because the investment in these items can be substantial, the appropriateness and promptness of adjustments made to compensate for the effect of ODS requisitions on forecasted peacetime requirements is important to minimize wholesale inventory investments.

DLA COMMENTS: PARTIALLY CONCUR. The general problem described in the draft report existed at only one DLA Center (DCSC). While there were isolated examples found at DESC, there was no evidence of a systemic problem.

ACTION OFFICER: Michael Pouy, DLA-OSP, 47975

PSE APPROVAL: JAMES J. GRADY, JR., Deputy Executive Director, Supply Operations, DLA-OD, 05 DEC 91

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

MANAGEMENT COMMENTS: DEFENSE LOGISTICS AGENCY (Cont'd)

FORMAT 2 OF 3

TYPE OF REPORT: AUDIT

DATE OF POSITION: 19 Dec 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Draft Quick Reaction Report on the Defense Logistics Agency's Adjustment of Wholesale Inventory Levels After Operation Desert Storm (Project No. 1LE-5003.02)

RECOMMENDATION 1: We recommend that the Director, Defense Logistics Agency, establish specific guidance on the elimination of Operation Desert Shield/Storm (ODS) demands from the computation of forecasted peacetime requirements and require feedback from the supply centers on the implementation of the guidance.

DLA COMMENTS: PARTIALLY CONCUR: DLA did establish specific guidance in March 91 to remove ODS experience from the demand base. We will restate and clarify this guidance as well as require implementation feedback. A copy of the 16 Mar 91 guidance is enclosed.

DISPOSITION:

(XX) Action is ongoing. Estimated Completion Date 17 Jan 1992
() Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: (WHERE APPLICABLE)

DLA COMMENTS: See recommendation 2.

ESTIMATED REALIZATION DATE:

AMOUNT REALIZED:

DATE REALIZED:

ACTION OFFICER: Michael Pouy, DLA-OSP, 47975

PSE APPROVAL: JAMES J. GRADY, JR., Deputy Executive Director, Supply Operations, DLA-OD, 05 DEC 91

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

Attachment

MANAGEMENT COMMENTS: DEFENSE LOGISTICS AGENCY (Cont'd)

FORMAT 3 OF 3

TYPE OF REPORT: AUDIT

DATE OF POSITION: 19 Dec 91

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Draft Quick Reaction Report on the Defense Logistics Agency's Adjustment of Wholesale Inventory Levels After Operation Desert Storm (Project No. 1LE-5003.02)

RECOMMENDATION 2: We recommend the Director, Defense Logistics Agency, direct the supply centers to recalculate forecasted requirements for items affected by Operation Desert Shield/Storm (ODS) demands, using the new guidance, and reduce or cancel excessive quantities of supply being procured, if economical.

DLA COMMENTS: PARTIALLY CONCUR: The DLA Supply Centers were directed on 20 March 91, to recalculate forecasted requirements for items affected by Operation Desert Shield/Storm (ODS) demands. In our clarification mentioned under recommendation 1, we will restate the need to reduce or cancel excessive quantities.

DISPOSITION:

(XX) Action is ongoing. Estimated Completion Date: 17 Jan 1992
() Action is considered complete.

RECOMMENDATION MONETARY BENEFITS: (WHERE APPLICABLE)

DLA COMMENTS: Partially Concur. The report claimed \$19.2 million savings. We concur with \$14.6 million in savings. A Procurement Request of \$4.6 million for barbed tape was required to maintain the industrial base, which was awarded in September 91.

ESTIMATED REALIZATION DATE: 31 Dec 1992

AMOUNT REALIZED:

DATE REALIZED:

ACTION OFFICER: Michael Pouy, DLA-OSP, 47975

PSE APPROVAL: JAMES J. GRADY, JR., Deputy Executive Director, Supply Operations, DLA-OD, 05 DEC 91

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

MANAGEMENT COMMENTS: DEFENSE LOGISTICS AGENCY (Cont'd)

161448Z MAR 91 RR UUUU GRACE07

FROM DLA CAMERON STA VA//DLA-0//C//P
TO DCSC COLUMBUS OH//D//
DESC DAYTON OH//D//
DGSC RICHMOND VA//D//
DISC PHILADELPHIA PA//D//
DPSC PHILADELPHIA PA//D//

UNCLAS

SUBJ: POST-OPERATION DESERT STORM (ODS) SUPPLY POLICY

- A. DLA-0 MSG 011630Z MAR 91, SUBJECT AS ABOVE.
- B. DLA SUPPLY CONFERENCE MEETINGS, 7-8 MAR 1991.
- C. REF A SET FORTH IMMEDIATE ACTIONS TO BE TAKEN FOLLOWING CESSATION OF HOSTILITIES. DURING REF B WE DEVELOPED A STRATEGY FOR REVISING INVENTORY MANAGEMENT POLICIES TO RESPOND TO THE EXPECTED DRAWDOWN IN REQUIREMENTS. FOR SOME CATEGORIES OF ITEMS, SPECIFIC GUIDANCE HAS BEEN RECEIVED (OR SOON WILL BE) FROM THE SERVICES REGARDING DISPOSITION OF ASSETS AND REQUIREMENTS. IN THE ABSENCE OF SUCH GUIDANCE, THE FOLLOWING SUPPLY POLICY CHANGES APPLY AND ARE EFFECTIVE IMMEDIATELY:

- A. DEMAND FORECASTS: DEMAND BASE WILL BE REVISED TO EXCLUDE ODS DEMAND EXPERIENCE. ITEMS WILL BE CLASSIFIED PROPERLY AS NSO OR

DLA-C, DLA-P, DLA-OC, DLA-OM, DLA-OS, DLA-OT, DLA-OW, DRSO

M. POUY/DLA-OSP/47975

J. P. DAVIDSON
Rear Admiral, USN
Supply Operations
UNCLASSIFIED
18 MAR 1991
DD FORM 1732 Supply Operations

Attachment

MANAGEMENT COMMENTS: DEFENSE LOGISTICS AGENCY (Cont'd)

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04-04	MAR 91	RR	UUUU				POUY
<p>G. RETURNS/ RETROGRADE DUE-IN</p> <p>H. PEACETIME (PRE-ODS) AVERAGE DEMAND</p> <p>I. ODS DEMAND TOTAL</p> <p>J. ADMINISTRATIVE AND PRODUCTION LEAD TIMES</p> <p>K. INDUSTRIAL PREPAREDNESS PLANNING (IPP) INFORMATION</p> <p>L. ODS BACKORDER QUANTITY</p> <p>M. ANY OTHER PERTINENT INFORMATION, E.G., DIFFICULTIES GETTING BIDS OR AWARDS, PRODUCTION/DELIVERY PROBLEMS, ETC.</p>							
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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. and 2.	<u>Economy and Efficiency.</u> Improve operations by avoiding premature or unnecessary investments in wholesale inventory.	<u>Funds Put to Better Use.</u> The report identifies about \$19.2 million in quantifiable monetary benefits. Additional unquantified monetary benefits should result from the Defense Logistics Agency's implementation of the recommendations.

ACTIVITIES VISITED OR CONTACTED

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Washington, DC
Defense Construction Supply Center, Columbus, OH
Defense Electronics Supply Center, Dayton, OH
Defense General Supply Center, Richmond, VA

AUDIT TEAM MEMBERS

Shelton R. Young, Director, Logistics Support Directorate
James B. Helfrich, Program Director
John K. Issel, Project Manager
David L. Luce, Team Leader
Eric T. Thacker, Auditor

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Senate Ranking Minority Member, Committee on Armed Services
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Committee on Government Operations

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