



DEPARTMENT OF DEFENSE

# AUDIT REPORT

BUDGETING FOR SECONDARY SUPPLY ITEMS  
BY THE MILITARY DEPARTMENTS

No. 91-067

March 20, 1991

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**INSPECTOR GENERAL**  
DEPARTMENT OF DEFENSE  
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March 20, 1991

MEMORANDUM FOR COMPTROLLER OF THE DEPARTMENT OF DEFENSE  
ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)  
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)  
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)  
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Report on the Audit of Budgeting for Secondary Supply Items by the Military Departments  
(Report No. 91-067)

This is our final report on the Audit of Budgeting for Secondary Supply Items by the Military Departments for your information and use. We made the audit from August 1989 through May 1990. Comments on a draft of this report were considered in preparing the final report. The overall audit objective was to determine if the Military Departments were adequately determining and accurately stating funding requirements for secondary supply items in their annual budget submissions. We also evaluated whether internal controls over the budgeting process were adequate. The Military Departments had forecasted funding requirements for secondary supply items of \$9.6 billion for fiscal year 1991.

Improving the planning and budgeting process is one of the six major goals contained in the Defense Management Report. We determined that funding requirements for secondary items identified in stratification deficits (insufficient assets to satisfy future requirements) were overstated. (Such overstatements can result in the approval of excess obligational authority for DoD stock funds.) Also, some adjustments (totaling \$69.4 million) used in transition statements that reconciled stratification funding totals to final budget submissions were not valid. The results of our audit are summarized in the following paragraphs, and the details and audit recommendations are in Part II of this report.

The Military Departments overstated budget year (FY 1991) stratification deficits by a net amount of \$475.4 million. These overstated deficits could result in the overstating of funding requirements and they are a factor in the growth of inapplicable

inventories. We recommended that the Assistant Secretary of Defense (Production and Logistics) amend policy to improve the stratification process of the Military Departments (page 5).

Three inventory control points (ICP's) submitted budgets that contained adjustments that were either inaccurate or were not supported by required documentation. These adjustments resulted in a net overstatement of \$69.4 million of funding requirements. We recommended that the Comptroller of the Department of Defense reduce the Air Force Stock Fund obligational authority by \$59.4 million for FY 1991 and reduce the Army Stock Fund obligational authority by \$10.0 million for FY 1991. We also recommended that the Commander, Army Materiel Command and the Commander, Air Force Logistics Command, amend guidance over the budget adjustment process to ensure reporting of significant decisions and events affecting the budget and retaining of documentation for significant adjustments (page 13).

A draft of this report was provided to the addressees for comments on October 18, 1990. As of March 11, 1991, the Comptroller of the Department of Defense had not responded. Comments were received from the Principal Deputy Assistant Secretary of Defense (Production and Logistics) on December 24, 1990. Comments were received from the Director for Resources and Management, Headquarters, Department of the Army, on December 14, 1990, and from the Chief, Aircraft and Missile Support Division, Headquarters, Department of the Air Force, on January 22, 1991. Appendixes E, F, and G, respectively, contain complete texts of management comments.

The Principal Deputy Assistant Secretary of Defense (Production and Logistics) partially concurred with Recommendations A.1. and A.2. and nonconcurred with Recommendation A.3. in the draft report. Regarding Recommendation A.1., we believe that the requirement to validate the stratification data should include parameters and priorities to ensure that stratification data having significant budgetary impact are reviewed. We ask that the Assistant Secretary of Defense (Production and Logistics) reconsider his position and provide comments in responding to the final report. Actions planned on Recommendation A.2. are considered responsive and no additional comments are required. We believe that the intent of Recommendation A.3. of the draft report can be met through implementation of Recommendations A.1. and A.2. Accordingly, we have deleted Recommendation A.3. from the final report.

We request that the Comptroller of the Department of Defense respond to the final report. In preparing his comments, he should consider the comments provided by the Department of the Air Force on Recommendations B.1.a., and B.1.b.

The Department of the Air Force disagreed with Recommendations B.1.a. and B.1.b. As discussed in Part II (Management Comments and Audit Response) of this report, we reduced the recommended savings in Recommendation B.1.a. by \$1.9 million based on the Air Force's comments, and reaffirmed the remaining \$51.3 million savings. We also reaffirmed the \$8.1 million savings of Recommendation B.1.b.


Our draft report included a recommendation (B.1.c.) that the Comptroller of the Department of Defense "reduce the Army Stock Fund obligational authority in fiscal year 1991 for reparable items by \$10.0 million." Since the Department of the Army subsequently took action to reduce its FY 1992/1993 stock fund submission by the \$10.0 million amount requested for "safety of flight" spares, we dropped the recommendation from our final report. However, we request that the Army address the monetary benefits associated with our draft Recommendation B.1.c., and include these comments in its response to the final report.

The Departments of the Army and the Air Force concurred with Recommendation B.2. Actions taken or planned are considered responsive to the recommendation and additional comments are not required to that recommendation.

This report identifies internal control deficiencies as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Internal controls did not adequately ensure that budget stratification data having a significant impact on the budget would be reviewed and corrected or that financial adjustments to the stratification were properly made. Recommendations A.1., A.2., and B.2., if implemented, will correct these weaknesses. Monetary benefits associated with Recommendations A.1. and A.2. were not readily identifiable and projectable because subsequent financial adjustments are not always directly relatable to line item stratification results. A copy of the final report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense and each of the Military Departments.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Accordingly, final comments on the unresolved issues in this report must be provided within 60 days of the date of this report. We request that the Comptroller of the Department of Defense, in coordination with the Military Departments, provide final comments on the estimated monetary benefits of \$69.4 million, identified in Appendix H of this report. Potential monetary benefits are subject to resolution in the event of nonconcurrence or failure to comment.

The courtesies and cooperation extended to the audit staff are appreciated. If you have any questions about this final report, please contact Mr. James Koloshey at (703) 614-6225 (AUTOVON 224-6225) or Mr. Stuart Dunnett at (703) 614-6222 (AUTOVON 224-6222). A list of the audit team members is in Appendix J. Final report distribution is shown in Appendix K.



Edward R. Jones  
Deputy Assistant Inspector General  
for Auditing

Enclosures

cc:  
Secretary of the Army  
Secretary of the Navy  
Secretary of the Air Force

REPORT ON THE AUDIT OF  
BUDGETING FOR SECONDARY SUPPLY ITEMS  
BY THE MILITARY DEPARTMENTS

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Prepared by:  
Logistics Support Directorate  
Project No. 9LA-0061

REPORT ON THE AUDIT OF BUDGETING FOR  
SECONDARY SUPPLY ITEMS  
BY THE MILITARY DEPARTMENTS

PART I - INTRODUCTION

Background

Funding for secondary supply items is a complex process involving the stock funds of the Military Departments and the Defense Logistics Agency (DLA) as well as the procurement and operations and maintenance appropriations of the Military Departments. Secondary supply items represent "readiness" resources and include consumables, such as nuts and bolts, and reparable, such as transmissions and engines, used to maintain and support major end items of equipment. There are over 4 million secondary supply line items in the DoD wholesale supply system.

The budgeting process for secondary supply items begins at each of the respective Inventory Control Points (ICP's) of the Military Departments. The initial budget step requires the calculation of line item deficits (insufficient assets to satisfy future requirements) as of March 31, 18 months before the budget year. This line item calculation process includes the accumulation, extraction, and display of basic supply data from subsystems that relate assets to requirements in a specific time sequence or issue period. Requirements are then arrayed against this time sequence, assets are applied, and a supply position by line item is developed. The developed stratification provides the annual funding requirements over a 2½-year period for items in a deficit position. For budget purposes, the stock funds' peacetime commitment and obligational authority requirements are derived from and supported by this line item simulation of buy stratification process, subject to adjustments. Adjustments that the ICP's and Military Departments make to the stratification deficits are discussed in greater detail in Finding B of this report. The adjusted stratification is the basis for the ICPs' budget submissions to their respective headquarter activities.

Budget analysts within the Office of the Comptroller of the DoD review the Military Departments' budget submissions for validity and executability. All major elements of the review are conveyed to the Military Departments as Program Budget Decisions (PBD's) that are signed by the Secretary or Deputy Secretary of Defense. PBD's establish the dollar levels for the obligational authority requests used by DoD in preparing its stock fund budget due to Congress in January for inclusion in the President's Budget.

## Objective and Scope

The objective of the audit was to determine whether the Military Departments were adequately determining and accurately stating their funding requirements for secondary supply items in their annual budget submissions and whether internal controls over this process were adequate. Specifically, we determined whether the Military Departments were requesting sufficient funds to buy the material required for the adequate and efficient support of the forces.

Based on the March 1989 stratification, the Military Departments forecasted budget year (FY 1991) deficits for 489,075 line items at \$6.9 billion (Appendix A). We used a stratified random sampling plan to select a sample of individual line items, with extended deficit values in excess of \$10,000, managed by two ICP's each from the Army, Navy, and Air Force. Our sample consisted of 831 line items, valued at \$944.2 million (Appendix B) from the above universe. We evaluated procedures, controls, and documentation used by the Military Departments' ICP's to ensure that forecasted budget year deficits were accurate. Our sampling plan and results are discussed in Appendix B. Additionally, we reviewed all adjustments in excess of \$10.0 million made to the summary line item stratification totals on the transition statements of selected ICP's to determine if these adjustments were supportable. We reviewed 107 adjustments with an absolute value of \$7.0 billion and a net value of \$1.4 billion (Appendix C).

This economy and efficiency audit was made between July 1989 and May 1990 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 I.

## Internal Controls

We evaluated internal controls used by the Military Departments to ensure the accuracy and reliability of budget forecasts for secondary supply items. We reviewed the policies, procedures, and controls related to the identification and correction of line item stratification outputs and program related adjustments. The audit concluded that verification procedures were not adequate because large dollar value requirements were not always reviewed, review procedures were not adequate to identify data errors, and corrections were not always entered into the data base. Details are provided in Findings A and B in Part II of this report.

### Related Audit Coverage

No previous audits have covered the stratification and budget adjustments process used by the Military Departments in budgeting for secondary supply items. However, the General Accounting Office (GAO) has issued several reports on the potential for reducing funding requirements for aircraft spares as discussed below.

GAO Report No. GAO/NSIAD-90-18, November 1989, "Air Force Budget: Potential for Reducing Funding for Aircraft Spares," OSD Case No. 8141, examined the potential for reducing the FY 1990 procurement appropriation request for aircraft spares. This review included an examination of the accuracy of budget estimating methodologies and concepts. GAO identified potential reductions and rescissions totaling \$743.1 million. Reductions and rescissions were caused by duplications in budgeting, premature buy requirements, unrecognized reduced requirements, cost reductions in the budget, and understated revenues. No recommendations were contained in this report.

GAO Report No. GAO/NSIAD-88-90BR, April 1987, "Air Force Budget: Potential for Reducing Requirements and Funding for Aircraft Spares," OSD Case No. 7541, examined the potential for reducing the Air Force's FY 1988 requirements and funding request for aircraft replenishment spares. DoD concurred with \$327.0 million of the \$1.2 billion in reductions GAO identified, including \$220.0 million in base safety level spares for the B-1 bomber and \$107.0 million in other adjustments. We determined that the Oklahoma City Air Logistics Center has begun to monitor adjustments for base safety level spares; however, the Air Force Logistics Command has not required adherence to procedures to prevent recurrence of duplication in budgeting.

An audit dealing with budgeting for secondary supply items in the Defense Logistics Agency is currently being conducted by the Logistics Support Directorate of the Office of the Assistant Inspector General for Auditing. The primary objective of the audit is to determine whether the Defense Logistics Agency is adequately determining and accurately stating funding requirements for secondary supply items in their annual budget submissions.

Two related audits are being conducted at the time of this audit by the Logistics Support Directorate of the Office of the Assistant Inspector General for Auditing. The "Audit of Military Services Requirements for Currently Procured Wholesale inventories," (Project No. 9LE-0064) is determine whether current procurement actions were supported by anticipated requirements.

On an on going audit of "Currently Procured Repairable Items" (Project OLE-0078), we are determining whether wholesale inventory control points are prematurely or unnecessarily procuring repairable items. These efforts compliment our audit objective that addressed the adequacy of funding requirements.

## PART II - FINDINGS AND RECOMMENDATIONS

### A. Budget Stratification Deficits

#### FINDING

The Military Departments overstated budget year stratification deficits (insufficient assets to satisfy future requirements) used to develop fiscal year 1991 funding requirements for secondary items. This condition occurred because the inventory control points (ICP's) did not have adequate verification procedures for reviewing budget year deficits. We estimated that the net overstatement amounted to \$475.4 million of the \$6.9 billion of budget year deficits forecasted by the Military Department's ICP's. The use of overstated stratification deficits could result in overstating funding requirements for secondary items. Also, these overstatements are a factor in the growth of inapplicable inventories.

#### DISCUSSION OF DETAILS

Background. The DoD Budget Guidance Manual (DoD 7110-1-M) requires the Military Departments to base their budgets for secondary supply items on a line item budget stratification prepared in accordance with DoD Instruction 4140.24, "Requirements Priority and Asset Application for Secondary Items." A list of the Military Departments' implementing regulations is provided in Appendix D. The budget stratification is a line item comparison of central supply system requirements and assets on hand and due in based on a "simulation of buy" concept. Comparisons that were run as of the end of March 1989 are simulated over 2½ years to identify line item deficit shortfalls that must be funded in stock fund or procurement budget accounts. Accurate logistics information must be used because inaccuracies will perpetuate themselves, annually, throughout the stratification and result in unreliable forecasts of funding requirements.

Analysis of Stratification Data Tapes. The Military Departments provided us with data tapes containing output from the March 1989 stratification for each of their respective ICP's. This stratification formed the basis for the secondary items budget request for FY 1991 and portrayed supply actions for FY 1989 (current year, second half), FY 1990 (apportionment year), and FY 1991 (budget year). The data tapes contained line item data for 489,075 replenishment items that had budget year deficits totaling \$6.9 billion (Appendix A). We determined that approximately 55,000 items, each having a budget year deficit

greater than \$10,000, represented only 11 percent of the total line items but over 96 percent (\$6.7 billion) of the total budget year deficit value. Therefore, we restricted our review to items whose budget year deficit value exceeded \$10,000.

Analysis of Stratification Deficits. We estimated that budget year deficits for 3,837 line items were in error and resulted in a net overstatement of \$475.4 million. We based our estimates on a sample of 831 items whose budget year deficit value totaled \$944.2 million (Appendix B). The errors were primarily a result of inadequate implementation of validation procedures as discussed in the following paragraphs.

Validation Procedures. Although each of the Military Departments has issued policies requiring the validation of stratification outputs, the respective ICP's have not adequately or uniformly implemented this policy. Specifically, inaccurate stratification deficits were caused by ICP's failure to uniformly identify for review high value line items; failure to assign high priority for the review of stratification deficits; failure to adequately review stratification deficits; and failure to ensure that identified discrepancies would be excluded from final stratification results.

Identification of High Value Line Items for Review. Parameters established by the selected ICP's as a basis for the automated screening of high value line items differed among the Military Departments and the ICP's within the Military Departments. For example, in its review of the stratification process, the Navy Aviation Supply Office did not consider the budget year deficit as a parameter for the automated selection of the line item for further review. Conversely, the Navy Ships Parts Control Center automatically selected budget year deficits exceeding \$100,000 for further review. At Ogden Air Logistics Center, we determined that the parameter for selection and review for the FY 1991 budget year deficits was set too high (over \$1.0 million). Only 143 consumable line items were identified for review. A lower selection parameter could result in correction of line item discrepancies. For example, we determined that one of our sample items, a cabin pressure indicator (national stock number 6685-01-141-9023), had a budget year deficit of eight items valued at \$913,520. Our review showed that the deficit amount was computed using an erroneous unit price of \$114,190 instead of the correct unit price of \$1,033, resulting in a \$905,256 overstatement that may have been corrected had the item manager identified and reviewed the item. We estimated that budget year deficits for the Military Departments were overstated by \$66.7 million (Appendix B, Category A) because of data discrepancies that existed in items not identified for review.

Priority of Line Item Reviews. Due to concerns about the high dollar value of inapplicable inventory, the ICP priority is to review line items in a long supply (available assets exceeding requirements) position in the current year's budget (FY 1989) or apportionment year budget (FY 1990), while line items with budget year (FY 1991) deficits were given a lower priority for review. For example, one of our sample items, a regulator receiver (national stock number 1440-01-026-3921), that is managed by the Navy Ships Parts Control Center, had a deficit of 10 valued at \$1,125,500. Our review disclosed that requirements for this item could be satisfied more economically through repair of carcasses returned from user activities instead of through new procurement. (Offsetting repair costs during the FY 1991 budget year would have been \$13,400 for one unit.) The item manager had not reviewed the March 1989 budget stratification for this item, even though it was identified for review by the automated screening process, because the review time had been devoted to reviewing long supply items. Therefore, this overstated requirement remained undetected and the FY 1991 budget year deficit was overstated by \$1,125,500. We estimated that budget year deficits for the Military Departments were overstated by \$48.3 million (Appendix B, Category B) due to the lower priority given to the review of previously identified line items.

Adequacy of Reviews. Item managers and supervisory staffs did not always perform adequate reviews of stratification deficits. For example, a jet blade (national stock number 2840-01-138-6855) managed by the San Antonio Air Logistics Center had a deficit quantity of 61,264 valued at \$22,594,775. The item manager indicated that this item was reviewed during the validation process. Our audit disclosed that demands used to compute the deficit quantity for this item were substantially overstated due to inclusion of two nonexistent transfers of 10,000 each. As a result, the budget stratification included: overstated annual demand (issue) requirements of 20,000; overstated annual inventory requirements for lead time due to the overstated demands; and an opening position understatement of on hand assets by 20,000. The subsequent stratification (September 1989) contained the corrected demand data and the budget year deficit was reduced to zero; however, these corrections were never made to the March 1989 stratification. We concluded that the budget year deficit for this item was overstated by \$22,594,775.

Another sample item, a signal processor (national stock number 5895-00-115-1493), managed by the U.S. Army Communications-Electronics Command, showed a deficit quantity of 17, valued at \$1,481,686. The item manager, who had reviewed the item during the validation process, stated that this stock number was being replaced and there would be no future buys of this item. We

concluded that the budget year deficit included on the March 1989 stratification for this item was overstated by \$1,481,686. We estimated that budget year deficits for the Military Departments were overstated by \$249.5 million (Appendix B, Category C) because of errors that were not identified during reviews.

Correction of Identified Discrepancies. Corrections of data base discrepancies were not being included in the final stratification results. For example, a turbine rotor blade (national stock number 3110-01-172-3338), that is managed by the Navy Aviation Supply Office, had a deficit of 861 items, valued at \$1,102,080. The item manager determined that the recurring demand forecast should be changed to a rate of 80 items per quarter. This change was approved and forwarded to operations personnel for entering into the stratification file. However, the final stratification reflected a quarterly demand rate of 160, twice the rate computed by the item manager. We estimated that the deficit for this item was overstated by \$551,680. We estimated that budget year deficits for the Military Departments were overstated by \$110.9 million (Appendix B, Category D) due to inadequate followup to ensure that identified data base discrepancies were not included in final stratification results.

Conclusion. Accuracy of the stratification process is important because it establishes the basis and reliability of budget requests made to Congress. The overstatement of stratification deficits could result in the overstatement of funding needs and the approval of excess obligational authority within DoD stock funds for secondary items. Furthermore, these excesses in obligational authority ultimately contribute to the continued existence of excessive and inapplicable inventories within the DoD. An August 1989 briefing by the Assistant Commander, Naval Supply Systems Command indicated that inaccurate demand forecasts was one of the four primary factors that caused inapplicable inventories.

The additional work load to review these line item deficits would be minimal. For example, at the Ogden Air Logistics Center, 375 item managers would be required to review 2,617 line items (an average of 7 line items per item manager) with deficits over \$10,000. A review of all budget year stratification deficits based on reasonable minimum thresholds would ensure that budget decisions were based on accurate stratification inputs.

#### RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Assistant Secretary of Defense (Production and Logistics) amend DoD Instruction 4140.24 to require the Military Departments to validate stratification results. As a minimum the revised policy should require the Military Departments to:

1. Establish reasonable parameters and priorities for the identification of stratification line item deficits for review.

2. Conduct stratification line item validations adequately and accurately and include the necessary internal controls to ensure that corrections are in final stratification results.

#### MANAGEMENT COMMENTS AND AUDIT RESPONSE

Management Comments on Finding A. The Principal Deputy Assistant Secretary of Defense (Production and Logistics) responded that the draft report was unclear as to whether any of the \$475.4 million of overstated stratification budget year deficits might have been corrected by the Military Departments through financial adjustments in their budget transition statements rather than through corrected stratifications. Also, the Principal Deputy noted that repeated references were made to overstatements but never to understatements, therefore, based on probability, understatements would tend to negate overstatements. The Principal Deputy believes that the absence of any mention of understatements raises questions about the fairness of the audit and the legitimacy of savings estimates made elsewhere in the report.

In response to the Finding, the Air Force questioned the accuracy of our conclusion related to a San Antonio Air Logistics Center item that is included as an example under "Adequacy of Reviews." The Air Force claimed the overstated sample item deficit was \$7.4 million instead of the \$22.6 million claimed in the report. The Air Force also noted that the procurement overstatement on a Navy deficit item identified under "Priority of Line Item Reviews" should have been offset by repair costs. In addition, on another Navy deficit item under "Correction of Identified Discrepancies" that had an erroneous doubling of demand, the Air Force noted ". . . the deficit was not entirely the result of the recurring demand forecast, yet the report concludes that the overstatement was half of the entire deficit."

Audit Response. Regarding the Principal Deputy's comments, we were unable to quantify subsequent Military Department adjustments as corrections to specific line items. The stratification is the starting point used in the preparation of the budget and is based on a line item analysis of assets and requirements at a given time. Financial adjustments in the transition statements account for subsequent actions not included in the stratification and are made on a macro-level basis. The type of errors identified during our audit are those that one would normally expect to identify during the individual stratification line item reviews performed by item managers and review teams. We did not identify any financial adjustments in the transition statements that were documented as being made for

the purpose of correcting such errors. We recognize that later financial adjustments could negate some of the impact of overstated stratification line item deficits. However, we do not believe that such macro-level adjustments can always be directly related to individual stratification line item errors. For these reasons, we did not attempt to identify or claim savings that may or may not have existed.

Our identification of line item errors was based on data current as of the stratification date, March 30, 1989. The estimated \$475.4 million overstated stratification deficit was a net amount. Our estimate was based on the identification of 93 sampling errors with a net overstated value of \$103.2 million. This included 83 overstatements valued at \$104.8 million and 10 understatements valued at \$1.6 million. We have updated the final report, where necessary, to reflect the identification of understatements during our review. We attributed the predominance of overstated requirements among the budget stratification line items to performance measurement factors that are more heavily weighted by item managers toward ensuring line item availability as opposed to prudent fiscal management.

The Air Force did not present all factors in questioning the accuracy of the example presented under "Adequacy of Reviews". We have provided additional information in the report to show the accuracy of the overstated \$22.6 million. We also reviewed the Air Force's concerns related to examples of Navy managed items and determined that there was no significant impact on the results or intent of the Finding. Regarding the Air Force comments on the Navy example under "Priority of Line Item Reviews," we revised the report to show the offsetting repair costs of \$13,400 that would be necessary during the FY 1991 budget year on that specific line item. Due to the relative insignificance of this change, we did not update our projected savings. As to comments on the Navy example under "Correction of Identified Discrepancies," the Air Force is correct in noting that the FY 1991 budget year deficit was not entirely the result of the recurring demand forecast. However, recurring demands directly impact inventory requirement levels that are included in deficit computations. The cited overstatement is a conservative estimate since we did not attempt to include the impact of the overstated requirements on deficits included in the current and apportionment years of the stratification.

Management Comments on Recommendation A.1. The Principal Deputy Assistant Secretary of Defense (Production and Logistics) partially concurred with the recommendation by agreeing to amend DoD stratification policy guidance to include a requirement to validate stratification data. The Principal Deputy agreed to include this guidance in a DoD Secondary Item Stratification Manual.

Audit Response. The Principal Deputy's comments are not fully responsive to the primary intent of the recommendation. The response did not address the establishment of "parameters and priorities" for the identification of the stratification line items requiring review. Stratification line item data having a significant dollar impact on the budget should be reviewed by the Military Departments. We believe that DoD policy should indicate the need for establishing reasonable parameters and priorities in the selection of stratification line item data for review. Accordingly, we request that the Principal Deputy reconsider his comments in response to the final report.

Management Comments on Recommendation A.2. The Principal Deputy Assistant Secretary of Defense (Production and Logistics) partially concurred with the recommendation by agreeing to establish internal controls to ensure that necessary corrections are made to stratification data and by agreeing to include this guidance in a DoD Secondary Item Stratification Manual, which is planned to be staffed by May 1991. The Principal Deputy questioned the specific wording of the recommendation that the actions be done "accurately and adequately."

Audit Response. The Principal Deputy's planned actions appear to satisfy the intent of the recommendation. Instead of providing comments to the final report, the Principal Deputy should provide us a draft copy of the above manual.

Management Comments on Recommendation A.3. The Principal Deputy Assistant Secretary of Defense (Production and Logistics) nonconcurred with Recommendation A.3. to "task item managers and supervisory review staffs to certify the accomplishment of reviews and the accuracy of data used in final calculations of stratification budget deficits." The Principal Deputy noted that 5 million stratifications are made annually and believes that requiring certifications that each stratification is correct would be an unreasonable requirement.

Audit Response. The intent of our recommendation was not to require certifications on every line item in the DoD inventory, but to ensure the accuracy of those line items selected for review. However, we believe that this can be satisfied through the implementation of Recommendations A.1. and A.2., as discussed above. Therefore, we have deleted Recommendation A.3. from the final report.

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## B. Budget Adjustments for Secondary Supply Items

### FINDING

Four adjustments made by one Army and two Air Force inventory control points (ICP's) to their respective FY 1991 budget estimates for secondary supply items were either inaccurate or inadequately supported. The adjustments were inaccurate because the ICP's made duplicate requests for obligational authority, did not update budget proposals, or did not have specific quantitative documentation. As a result, the FY 1991 request for obligational authority for secondary supply items was overstated by \$69.4 million.

### DISCUSSION OF DETAILS

Background. DoD Instruction 4140.24, states that:

For budget purposes, the peacetime commitment and obligation authority requirement will be derived from and supported by a line item simulation-of-buy stratification process, subject to adjustments for changes in program data, requirement factors, financial accounting data, etc., not included in the basic computation and to be shown separately.

DoD Budget Guidance Manual, DoD 7110-1-M, provides additional guidance to the Military Departments on how their respective budgets are to be prepared, and provides the supporting exhibits that are to be submitted to the Comptroller of the DoD. The manual also requires that while supporting stratification data need not be forwarded with the required exhibits, the products should be available for inspection upon request.

To standardize the budget development process within each of the Military Departments, additional guidance has been issued to respective ICP's. The ICP's are required to prepare a transition statement that begins with the results of the March stratification. As necessary, adjustments to the stratification are summarized and entered onto the transition statement. The final total of the transition statement represents the proposed budget amount for each year presented.

The adjustments entered on the transition statements are broken down into two categories. The first category consists of ICP budget analyst revisions to the basic March stratification computation. Examples include provisioning adjustments, changes resulting from mid-year demand level adjustments, pricing changes, and corrections of detected errors. The second category includes adjustments required because of higher level command reviews after the adjusted March stratification computation and ICP adjustments. Examples of these adjustments include

headquarters directed changes in inventory levels, across the board budget adjustments for lead time and demand changes, adjustments for changes in safety level, and inclusion or exclusion of special program requirements.

Review of Adjustments. The Military Departments' ICP's processed adjustments that amounted to a net increase of \$2.7 billion (39.0 percent) over the \$6.9 billion stratification deficits in their respective FY 1991 budget proposals (Appendix A). Because of the number and complexity of the adjustments made by the six ICP's visited and the time constraints imposed on the audit, we were not able to verify the accuracy of each adjustment. However, we reviewed the documentation for all adjustments totaling \$10.0 million and over, to determine whether the adjustments were reasonable and whether they were supported. We discussed each selected adjustment with the appropriate ICP budget analyst to determine the source of the data entered on the transition statements. We reviewed 107 adjustments with an absolute value of \$7.0 billion and a net value of \$1.4 billion (Appendix C). Although our audit disclosed that the Military Departments' adjustments were generally supportable, we determined that approximately \$69.4 million of adjustments were either overstated (\$31.4 million) or unsupported (\$38.0 million). The errors occurred because of duplicative requests for obligation authority, not updating budget proposals, and lack of quantitative support. These factors are discussed in the following paragraphs.

Duplicative Requests for Obligational Authority. San Antonio Air Logistics Center (SAALC) personnel took actions to transfer funding for base safety level spares for the B-1 bomber to another fiscal year that resulted in a duplicative funding request. We determined that SAALC personnel incorrectly adjusted the reparable item budget for base safety level spares for the B-1 bomber by transferring and adjusting \$27.9 million requested for obligational authority as follows: \$19.0 million from FY 1989 (apportionment year) to FY 1991 (extended year); \$8.0 million from FY 1990 (budget year) to FY 1991 (extended year); and adding \$.9 million for inflation adjustments in FY 1991. By transferring funds to FY 1991 that were originally requested and approved in the apportionment year (\$19.0 million) and budget year (\$8.0 million) and by adding an adjustment of \$.9 million, the SAALC was requesting duplicate funding because the extended year is the basis of the current budget request (FY 1991) to Congress. The apportionment year (FY 1989) and the budget year (FY 1990) procurement request amounts were previously approved and funded by Congress. Thus, SAALC requested funding for safety level spares that were already funded. As discussed in Part I of this report, GAO identified similar conditions in its reviews of Air Force budgeting for secondary spares and DoD concurred in the budget reductions of \$220.0 million recommended in GAO's reports for duplicative budgeting.

Based on information subsequently provided by Headquarters, United States Air Force (Air Staff), we determined that only \$6.1 million of the \$8.0 million in obligational authority transferred from fiscal year 1990 had been previously budgeted for and approved by Congress. In addition, Air Staff personnel informed us that records were no longer available to determine how much of the remaining \$19.9 million, transferred from SAALC's fiscal year 1989 budget, had been previously approved. Consequently, we are adjusting our recommendation to the Comptroller of the DoD to reduce the Air Forces' fiscal year 1991 Stock Fund obligational authority by \$26.0 million rather than the \$27.9 million originally stated in our report. Of the \$26.0 million, \$19.9 million was unsupported, and the remaining \$6.1 million we classified as being overstated.

Updating Budget Proposal. Air Force budget personnel did not update their FY 1991 budget proposal to DoD even though the Air Force reduced its own mid-year budget based on a Secretary of Defense decision to exclude Minuteman II spares reliability funds from the DoD budget. Ogden Air Logistics Center (OOALC) increased its FY 1991 budget request by a \$31.8 million adjustment for Minuteman II spares. Follow-up reviews at the Air Force Logistics Command (AFLC) and Air Staff indicated that the \$31.8 million adjustment remained in the Air Force submission to DoD. DoD budget analysts later transferred \$6.5 million of the request from the Air Force's FY 1991 proposal to FY 1992 to align the funding request with the Minuteman II requirements schedule, leaving \$25.3 million in the FY 1991 budget request.

We determined that OOALC deleted the \$31.8 million from its mid-year (September 1989 budget cycle) budget proposal to AFLC, based on a Secretary of Defense decision to exclude Minuteman II spares reliability funds from the DoD budget. However, there was no action by OOALC or Air Staff to inform DoD budget analysts to reduce the funding request for Minuteman II spares from the DoD budget prior to submission to Congress. As a result, the Air Force's FY 1991 request for stock fund obligational authority was overstated by \$25.3 million.

Documenting Quantitative Support. The Military Departments were not able to provide documented support for several upward adjustments to their respective FY 1991 budget proposals. SAALC personnel lowered their FY 1989 (current year) budget proposal for obligational authority by \$28.9 million. SAALC personnel informed us that the downward adjustment was based on an across-the-board estimate rather than an in-depth review of all C-5A aircraft "insurance items." We identified three C-5A insurance items (national stock

numbers 1560-01-278-2959, 1560-01-278-2956, and 1560-01-278-2964) with unsupported "insurance" demand that resulted in overstated deficits totaling \$37.0 million (\$18.5 million per year for fiscal year 1990 and 1991). SAALC personnel stated that the \$28.9 million adjustment was to correct the overstatement for the three items identified in our sample; however, the budget analyst could not explain how the \$28.9 million adjustment was arrived at or why the full amount was applied against its FY 1989 (current year) budget proposal. While the \$28.9 million downward adjustment covered all of the FY 1990 overstatement (\$18.5 million), the remaining \$10.4 million covered only a portion of the FY 1991 overstatement (\$18.5 million) leaving \$8.1 million still unsupported.

The U.S. Army Aviation Systems Command (AVSCOM) made an upward adjustment to its FY 1991 budget of \$10 million for "safety of flight reasons." The rationale for the adjustment was that funds have been needed each year for unplanned flight safety spares not previously budgeted. AVSCOM personnel had not retained historical data to support this increased level of funding. As a result, AVSCOM was unable to provide quantitative support for this adjustment. Thus, \$10 million of the Army's requirement for secondary supply item obligational authority in FY 1991 was unsupported.

Subsequent Action. The Army took action to reduce its FY 1991 funding requirements by \$10.0 million. The Army's response to the draft report stated that these fiscal year 1991 funding requirements were removed from the reparable budget before submission of the FY 1992/1993 stock fund budget submission to the Office of the Comptroller of the Department of Defense on September 15, 1990, and that further reductions would be duplicative. Therefore, we deleted draft Recommendation B.1.c., to the Comptroller of the Department of Defense, from the final report.

Conclusion. Budget adjustments for secondary supply items should be prepared consistent with existing guidance and regulations; furthermore, all adjustments should be adequately supported by exhibits and written documentation. These actions will ensure that the integrity of the budgeting process is maintained and funding requirements are neither overstated nor understated.

## RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Comptroller of the Department of Defense:

a. Reduce the Air Force Stock Fund obligational authority in fiscal year 1991 for reparable items by \$51.3 million for base safety level spares for the B-1 bomber (\$26.0 million) and replenishment spares for the Minuteman II (\$25.3 million).

b. Reduce the Air Force Stock Fund obligational authority in fiscal year 1991 for consumable items by \$8.1 million for overstated C-5A aircraft insurance items that were not corrected.

2. We recommend that the Commander, Army Materiel Command and the Commander, Air Force Logistics Command amend guidance over the budget adjustment process at the inventory control points. As a minimum, reemphasize that budget adjustments be made to appropriate fiscal years in accordance with existing regulations; require that significant decisions and events affecting the budget and occurring after the budget cycle be reported to higher levels of the Military Departments and DoD; and reemphasize that adequate support be retained for all significant budget adjustments.

## MANAGEMENT COMMENTS AND AUDIT RESPONSE

Management Comments on Recommendations B.1.a. and B.1.b. and draft report Recommendation B.1.c. Comments from the Comptroller of the Department of Defense were due December 18, 1990. We had not received comments as of March 11, 1991.

Although Recommendations B.1.a. and B.1.b. and draft report Recommendation B.1.c. were addressed to the Comptroller of the Department of Defense, the Air Force and Army provided the following comments.

The Air Force partially disagreed with Recommendation B.1.a. and totally disagreed with Recommendation B.1.b. to reduce its requests for fiscal year 1991 Stock Fund obligational authority for reparable and consumable secondary items by \$53.2 million and \$8.1 million, respectively.

Concerning Recommendation B.1.a., the Air Force indicated that only \$6.1 million of the \$27.9 million quoted in our draft report for base safety level spares for the B-1 bomber actually represented duplicative budgeting. The previously budgeted funds (FY 1989 and 1990) for spares were not spent because of Headquarters, AFLC policy not to buy safety level requirements for those items that have not experienced actual demands. The

Air Force did concur in the reduction of obligational authority by \$25.3 million because the budget request was not updated with reduced Minuteman II replenishment spares requirements.

The Air Force disagreed with Recommendation B.1.b. that the Comptroller of the Department of Defense reduce the Air Force Stock Fund obligational authority for consumable items by \$8.1 million. The Air Force stated that the audit report neglected to consider that Headquarters, AFLC reduced the San Antonio Air Logistics Center (SAALC) fiscal year 1991 budget deficit by \$26.5 million for overstated demands and stratification errors, which they contend included the \$8.1 million overstatement of C-5A aircraft insurance items.

The Department of the Army disagreed with draft report Recommendation B.1.c. to the Comptroller of the Department of Defense to "reduce the Army Stock Fund obligational authority in fiscal year 1991 for reparable items by \$10.0 million." The Army responded that these fiscal year 1991 funding requirements were removed from the reparable budget before submission of the FY 1992/1993 stock fund budget submission to the Office of the Secretary of Defense on September 15, 1990, and that further reductions would be duplicative.

Audit Response. We request that the Comptroller of the Department of Defense provide comments in accordance with DoD Directive 7650.3 on Recommendations B.1.a. and B.1.b. in response to the final report.

The Air Force's comments pertaining to Recommendation B.1.a. were partially responsive. The Air Force's agreement with the \$25.3 million in overstated obligational authority in Minuteman II replenishment spares was responsive. However, its comments on the \$27.9 million overstatement of base level stock spares for the B-1 bomber were only partially responsive. Based on information provided by the Air Force, we have revised our report to indicate that \$6.1 million, rather than the \$8.0 million originally shown, was deferred from a previously approved budget (fiscal year 1990). Air Force personnel informed us, in writing, that records on transferring the \$19.9 million in obligational authority (from FY 1989 to FY 1991) are no longer available. Therefore, there is no way to determine how much of the transfer may have been deferred from previously approved budget requests. It is our opinion that the \$19.9 million should be disallowed because it is unsupportable.

We adjusted Recommendation B.1.a. requesting that the Comptroller of the Department of Defense reduce the Air Force Stock Fund obligational authority for fiscal year 1991 by \$51.3 million rather than the \$53.2 million recommended in our draft report. The \$51.3 million adjustment consists of the \$25.3 million overstatement in Minuteman II replenishment spares, \$6.1 million in duplicative budgeting for base safety level spares adjustments

for the B-1 bomber (deferred transfers from the Air Force fiscal year 1990 request), and \$19.9 million in unsupported transfer of obligational authority from the Air Force fiscal year 1989 budget request for base safety level spares.

The Air Force's comments concerning Recommendation B.1.b. were accurate in stating that HQ AFLC had reduced SAALC's fiscal year 1991 budget by \$26.5 million for "overstated demands stratification errors." However, this amount represented an across the board reduction directed by HQ AFLC to bring each of the five Air Logistics Centers' budget submissions into line with the total HQ AFLC projection. As stated in our report, the \$8.1 million recommended reduction was based on specific overstatements on three C-5A aircraft insurance items totaling \$37.0 million for fiscal years 1990 and 1991. SAALC personnel caught the error and adjusted their fiscal year 1989 (current year) budget by an "estimated amount" of only \$28.9 million.

It is our opinion that had SAALC personnel correctly reduced its request for Stock Fund obligational authority by the full amount of overstatement (\$37.0 million), the amount of HQ AFLC's adjustment to SAALC's budget would still have been \$26.5 million. Therefore, we recommend that the Comptroller, DoD reduce the Air Force's Stock Fund obligational authority by \$8.1 million.

The actions taken by the Army meet the intent of Recommendation B.1.c. However, we request that the Army acknowledge the \$10.0 million reduction in obligational authority as a monetary benefit resulting from this audit in its response to our final report.

Management Comments on Recommendation B.2. The Departments of the Army and of the Air Force concurred with the recommendation. The Department of the Army stated that the required actions have been accomplished in development of draft DA Pamphlet 37-1, which is projected for publication in the fourth quarter of FY 1991. The Department of the Air Force stated that it would reemphasize compliance with existing regulations in its March 1991 budget call.

Audit Response. Planned actions by the Departments of the Army and the Air Force meet the intent of the recommendation.

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**SUMMARY OF FY 1991 BUDGET YEAR SUBMISSIONS**  
(Dollars in Billions)

Military Department	(1) FY 1991 Stratification Deficit Value <sup>1/</sup>	(2) Net Inventory Control Point Adjustments <sup>2/</sup>	(3) Inventory Control Point Budget Submission <sup>3/</sup>
Army	\$2.5	\$0.6	\$3.1
Navy	2.1	0.2	2.3
Air Force	<u>2.3</u>	<u>1.9</u>	<u>4.2</u>
	<u>\$6.9</u>	<u>\$2.7</u>	<u>\$9.6</u>

<sup>1/</sup> Stratification is the process that compares projected requirement levels against available assets to determine asset deficiencies.

<sup>2/</sup> Adjustments consist of ICP budget analyst revisions to the basic March stratification computation, and adjustments required because of higher level Command reviews after the adjusted March stratification computation and ICP adjustments.

<sup>3/</sup> Column (1) plus Column (2); Military Departments budget submissions contained in DoD Budget FY 1991 Budget Estimates-Stock Fund Overview.

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## STATISTICAL SAMPLING PLAN AND RESULTS

The Military Departments provided data tapes containing output from the March 1989 stratification for each of their respective inventory control points (ICP's). These data tapes contained line item data for 489,075 replenishment items that had budget year deficits totaling \$6.9 billion. We limited our review to budget year deficits with an extended value of \$10,000 or more. Those deficits valued at \$10,000 or more accounted for about 97 percent of the dollar value (\$6.7 billion) and represented about 11 percent of individual line items (54,957). We used a stratified random sampling plan to select a sample of individual line items managed by two ICP's each from the Army, Navy, and Air Force. Our total sample consisted of 831 items whose budget year deficit value totaled \$944.2 million, broken down as follows.

<u>Component</u>	<u>Sample Number</u>	<u>Site Value</u> (Millions)
Army	253	\$400.3
Navy	279	221.8
Air Force	299	322.1
	<u>831</u>	<u>\$944.2</u>

We projected the sample results with a confidence level of 95 percent and a sampling precision of  $\pm$  24 percent for attributes and  $\pm$  4 percent for dollars. Based on the results of our review, we estimated that 3,837 budget year deficits were overstated by a net amount of \$475.4 million on the March 1989 stratification due to discrepancies in the data base from which the deficits were calculated. Our projections of overstatements were divided into the following four general categories:

Category A: Net overstatements due to data discrepancies included in items that were not identified as requiring review during the automated screening processes.

Category B: Net overstatements due to data discrepancies included in items that were not reviewed by item managers after having been identified by automated screening processes.

Category C: Net overstatements due to data discrepancies that were not identified during the item manager's review.

Category D: Net overstatements due to inadequate followup to ensure that identified data base discrepancies were corrected on the final stratification.

STATISTICAL SAMPLING PLAN AND RESULTS (Continued)

A summary of sample results and projections in each of the four categories is included below.

	<u>Exceptions Noted</u>		<u>Projected Errors</u>	
	<u>Number</u>	<u>\$ Value</u>	<u>Number</u>	<u>\$ Value</u>
		(Millions)		(Millions)
Category A:				
Army	0	\$ 0	0	\$ 0
Navy	10	2.3	995	49.3
Air Force	4	1.0	502	17.4
Total	<u>14</u>	<u>\$3.3</u>	<u>1,497</u>	<u>\$ 66.7</u>
Category B:				
Army	5	\$2.6	67	\$ 14.2
Navy	14	4.3	881	23.2
Air Force	8	1.1	284	10.9
Total	<u>27</u>	<u>\$8.0</u>	<u>1,232</u>	<u>\$ 48.3</u>
Category C:				
Army	12	\$ 6.4	153	\$ 44.1
Navy	6	2.5	149	13.0
Air Force	22	56.1	545	192.4
Total	<u>40</u>	<u>\$65.0</u>	<u>847</u>	<u>\$249.5</u>
Category D:				
Army	2	\$ 2.3	40	\$ 27.7
Navy	6	6.1	46	10.4
Air Force	4	18.5	175	72.8
Total	<u>12</u>	<u>\$26.9</u>	<u>261</u>	<u>\$110.9</u>
Totals:				
Army	19	\$11.3	260	\$ 86.0
Navy	36	15.2	2,071	95.9
Air Force	38	76.7	1,506	293.5
Total	<u>93*</u>	<u>\$103.2*</u>	<u>3,837</u>	<u>\$475.4</u>

\* Exceptions included 83 overstated items valued at \$104.8 million and 10 understated items valued at \$1.6 million.

**REVIEW OF FY 1991 BUDGET ADJUSTMENTS**  
(DOLLARS IN BILLIONS)

<u>Military Department</u>	<u>Number of Adjustments Greater than \$10 Million Reviewed</u>	<u>Absolute Value in Dollars of Adjustments Reviewed</u>	<u>Net Value in Dollars of Adjustments Reviewed</u>
Army <u>1/</u>	17	.6	\$ .5
Navy <u>2/</u>	75	5.9	.6
Air Force <u>3/</u>	<u>15</u>	<u>.5</u>	<u>.3</u>
Totals	<u>107</u>	<u>\$ 7.0</u>	<u>\$1.4</u>

1/ Adjustments at Army Inventory Control Points:

- Aviation Systems Command
- Communications-Electronics Command

2/ Adjustments at Navy Inventory Control Points:

- Aviation Supply Office
- Ship Parts Control Center

3/ Adjustments at Air Force Inventory Control Points:

- San Antonio Air Logistics Center
- Ogden Air Logistics Center

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## REGULATORY GUIDANCE

### Department of Defense

DoD Budget Guidance Manual, DoD 7110-1-M

DoD Instruction 4140.24, "Requirements Priority and Asset Application for Secondary Items"

### Army

Regulation 710-1, "Inventory Management, Centralized Inventory Management of the Army Supply System"

CCSSOI 18-710-102, "Army Command Commodity Standard System Operating Instructions," Volume 1

### Navy

Publication 514, "Navy Secondary Item Requirements and Budget Development Manual"

OPNAV Instruction 4440.16B, "Requirements Priority and Asset Application for Secondary Items"

NAVSUP Instruction 4440.47J, "Requirements Determination and Stratification of Assets"

### Air Force

AFLC Regulation 57-4, "Recoverable Consumption Item Requirements System (D041 System)"

AFLC Regulation 57-6, "Requirements Procedures for Economic Order Quantity (EOQ) Items (D062 System)"

AFLC Regulation 57-19, "Air Logistics Centers Requirements, Reviews, and Signature Levels"

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ASSISTANT SECRETARY OF DEFENSE

WASHINGTON DC 20301-8000

December 24, 1990

(L/SD)

MEMORANDUM FOR DOD INSPECTOR GENERAL

SUBJECT: Response to the Draft Report on the Audit of Budgeting  
for Secondary Supply Items (Project No. 9LA-0061)

This memorandum responds to your memorandum dated October 18, 1990, requesting comments on subject draft report. A detailed response is provided in the attachment.

We appreciate the opportunity to comment on this audit report in draft form.

David J. Berteau  
Principal Deputy

Attachment

Response To Findings and Recommendations  
OIG REPORT NO. 9LA-0061

Final Report  
Page No.

6

Finding A: Budget Stratification Deficits

The "Analysis of Stratification Deficits" paragraph on page 9 indicates that the auditors estimate that the Services overstated budget year deficits by \$475.4 million based on an analysis of the Military Departments' stratification data tapes. The report is unclear as to whether any of these errors may have been subsequently corrected by the Military Departments through financial adjustments in their budget transition statements rather than through corrected stratifications. We recommend that the detailed discussion under this finding clarify this point, and, if applicable, the budget year deficit estimate be adjusted for any errors corrected in the transition statements.

Secondly, throughout the draft report, repeated references are made to stratification data errors which result in overstatement of requirements, but never understatements. Based on probability, one would expect errors in both directions, i.e., understatements as well as overstatements, and that, to some extent, the understatements would negate the overstatements. While your memorandum forwarding the draft audit indicates no specific savings are identified to the recommendations associated with Finding A, the absence of any mention of understatements raises questions as to the fairness of the audit and the legitimacy of savings estimates elsewhere in the draft report. Recommend that the report address this issue and its relation to deficit overstatement and savings estimates.

"RECOMMENDATION: We recommend that the Assistant Secretary of Defense (Production and Logistics) amend DoD Instruction 4140.24 that requires the Military Departments to validate stratification results. As a minimum the revised policy should require the Military Departments to:

A1. Establish reasonable parameters and priorities for the identification of stratification line item deficits for review.

A2. Conduct stratification line item validations adequately and accurately and include the necessary internal controls to ensure that corrections are in final stratification results.

A3. Task item managers and supervisory review staffs to certify the accomplishment of reviews and the accuracy of data used in final calculations of stratification budget deficits."

DoD Response: Partially concur with recommendations A1 and A2. We concur with amending DoD stratification policy guidance to include a requirement to validate stratification data and to establish internal controls to ensure that necessary corrections are made.

Recommendation A2 suggests that our policy should require that stratification data validations be accomplished "... accurately and adequately ..." which implies that, otherwise, the Services might accomplish validations inaccurately and inadequately. We do not concur with inserting this requirement in DoD 4140.24, since we plan to eliminate it as a separate Instruction. However, we are currently drafting a DoD Secondary Item Stratification Manual in which we will propose provisions which we believe will be responsive to the your Recommendations A1 and A2, without necessarily using your precise wording. We plan to staff the draft guidance by next May.

We do not concur with recommendation A3 and suggest that it be deleted. Requirements stratifications, like all forecasts, are inherently inexact. The stratification process predicts future requirements based on current data. Inventory management data changes daily so that even if the data is accurate today, it may not be tomorrow. With five million item stratifications annually, we know some stratifications will be inaccurate, but overall, we believe that they produce an a valid estimate of our total requirements. Requiring certifications that each item stratification is correct, when we know many are not, would be an unreasonable requirement. Moreover, if we required certifications every time one of our policies wasn't followed, a certification requirement would be a standard provision in every DoD policy. DoD stratification policy does not currently address data validation, and we propose to fix that. Additional policy requiring certifications is unnecessary.

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DEPARTMENT OF THE ARMY  
OFFICE OF THE DEPUTY CHIEF OF STAFF FOR LOGISTICS  
WASHINGTON, D C 20310-05



DALO-RMI

19 DEC 1990

MEMORANDUM THRU

~~DEPUTY CHIEF OF STAFF FOR LOGISTICS~~

*ELAN  
11 DEC 90*

~~DIRECTOR OF THE ARMY STAFF~~

*DRG 1412*  
DAVID R. GALLAY, LTC, GS ADAS

*12/14/90*

ASSISTANT SECRETARY OF THE ARMY (INSTALLATIONS, LOGISTICS AND ENVIRONMENT)

FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE (AUDITING)

SUBJECT: Draft Report on the Audit of Budgeting for Secondary Supply Items (Project No. 9LA-0061)--INFORMATION MEMORANDUM

1. Reference IG, DOD memorandum, 18 Oct 90, subject as above.
2. As requested, attached are Department of the Army comments on subject draft audit report.

*J. Brown*

Encl

JAMES T. BROWN  
Director for Resources  
and Management

SAILE-LOG - Concur, Mr. Croom/75727 (conference)  
AMCSM-MSR - Concur, Mr. Blackwell/274-9805 (conference)

Mr. Clark/73122

*07/0/CLW Galt*

COMMAND REPLY

DODIG Draft Report. Budgeting for Secondary Supply Items, Project 9LA-0061

**FINDING:** The Military Departments overstated budget year stratification deficits (insufficient assets to satisfy future requirements) used to develop fiscal year 1991 funding requirements for secondary items. This condition occurred because the inventory control points (ICPs) did not have adequate verification procedures for reviewing budget year deficits. We estimated that the overstatement amounted to \$475.4 million of the \$6.9 billion of budget year deficits forecasted by the Military Department's ICPs. The use of overstated stratification deficits could result in overstating funding requirements for secondary items. Also, these overstatements are a factor in the growth of inapplicable inventories.

**RECOMMENDATION:** We recommend that the Assistant Secretary of Defense (Production and Logistics) amend DOD Instruction 4140.24 that requires the Military Departments to validate stratification results. As a minimum, the revised policy should require the Military Departments to:

1. Establish reasonable parameters and priorities for the identification of stratification line item deficits for review.

**ACTION TAKEN.** Partially concur. Four of the six AMC ICPs currently have reasonable parameters and priorities for review of stratification line deficits. However, action is being taken to standardize the parameters for review of items which project large Budget Year deficits each quarter. Correspondence will be furnished to the ICPs by 19 Dec 90. This change will be implemented in the 31 Dec 90 Budget Stratification.

2. Conduct stratification line item validations adequately and accurately and include the necessary internal controls to ensure that corrections are in final stratification results.

**ACTION TAKEN.** Concur. All AMC ICPs routinely execute a stratification correction cycle. After the initial budget stratification cycle is completed, item managers are given approximately three weeks to review item stratifications which exhibit exceptional conditions and enter corrective actions into the data base if necessary. All transactions input into the Budget Stratification system are reviewed and monitored by dollar value of change. Final review of transactions is performed by Stratification Managers prior to execution of the final stratification. At present, the correction cycle is to be completed no later than 45 days after the stratification cutoff date; i.e., 45 days after the

end of the previous quarter. This issue will be added to the content of the AMC Policy Compliance Reviews and Staff Assistance Visits to ICPs. The reviews will include an audit trail of proposed corrections to the final stratification to verify that they were accomplished. These visits alternate between ICPs in succession each quarter.

3. Task item managers and supervisory review staffs to certify the accomplishment of reviews and the accuracy of data used in final calculations of stratification budget deficits.

**ACTION TAKEN.** Concur. An audit trail of all supply actions processed is maintained in accordance with dollar value approval thresholds as outlined in AR 710-1, Centralized Inventory Management of the Army Supply System, Table 4-2. This restriction applies to procurement, repair, disposal, cutback actions and data base updates. Data Base Advisory Groups have been established at all ICPs to ensure the accuracy of data used to calculate deficits in Budget Stratification. Data are validated prior to the running of the quarterly Requirements Determination and Execution System which feeds requirements to the Budget Stratification System. The correction cycle then acts as an additional screening of data.

**FINDING:** The U.S. Army Aviation Systems Command (AVSCOM) made an upward adjustment to its FY 91 budget of \$10 million for "safety of flight reasons." The rationale for the adjustment was that funds have been needed each year for unplanned flight safety spares not previously budgeted. AVSCOM personnel had not retained historical data to support this increased level of funding. As a result, AVSCOM was unable to provide quantitative support for this adjustment. As a result, \$10 million of the Army's requirement for secondary supply item obligational authority in FY 91 was unsupported.

**RECOMMENDATION No. 1:** We recommend that the Comptroller of the Department of Defense:

a. Reduce the Army Stock Fund obligational authority in fiscal year 1991 for reparable items by \$10.0 million.

**ACTION TAKEN:** Nonconcur. FY 91 funding requirements identified for safety of flight were removed from the AVSCOM reparable budget prior to submission of the FY 92/93 stock fund budget to OSD on 15 Sep 90. Further reductions would be duplicative.

RECOMMENDATION No. 2: We recommend that the Commander, Army Materiel Command and the Commander, Air Force Logistics Command amend guidance over the budget adjustment process at the inventory control points. As a minimum, reemphasize that budget adjustments be made to appropriate fiscal years in accordance with existing regulations; require that significant decisions and events occurring after the budget cycle be reported to higher levels of the Military Departments and DOD; and reemphasize that adequate support be retained for all significant budget adjustments.

ACTION TAKEN: Concur. This has been accomplished in development of draft DA Pamphlet 37-1 which is projected for publication in the fourth quarter of FY 91.



DEPARTMENT OF THE AIR FORCE  
HEADQUARTERS UNITED STATES AIR FORCE  
WASHINGTON DC

22 JAN 1991

REPLY TO  
ATTN: OF

LEXW

SUBJECT

DoD(IG) Draft Report of the Audit of Budgeting for Secondary  
Supply Items, dated October 18, 1990 (Project No. 9LA-0061)

TO

SAF/FMABA

1. We have reviewed the subject draft audit report and have noted that the overstatements identified are in many cases based on faulty analyses---and are therefore themselves overstated. Under Finding A, "Budget Stratification Deficits," for example:

a. The report notes that the Navy deficit item identified in "Priority of Line Item Reviews" can be repaired more economically than it can be purchased and that the entire dollar amount is an overstatement. However, the overstatement should have been reduced by the amount of repair expenses.

b. Similarly, the report cites a San Antonio ALC item under "Adequacy of Reviews" as overstated due to an error in the inventory records. The report concludes that the total deficit value is an overstatement when it should have reduced that value by an amount equivalent to the inventory error.

c. Under "Correction of Identified Discrepancies," the report cites the deficit quantity for a Navy turbine blade as overstated due to an erroneous doubling of demand quantities. The numbers given indicate that deficit was not entirely the result of the recurring demand forecast, yet the report concludes that the overstatement was half of the entire deficit.

2. In each case, the report extrapolates such calculations for items in the sample population to arrive at inflated estimates of Service overstatements of requirements.

3. A full discussion of audit findings and recommendations is attached.

GRC/FRL DUNN  
Criet, Actt & Msl Spt Div  
Dir of Logistics Programs  
DCS/Logistics & Engineering

1 Atch  
Response to DoD IG Audit

RESPONSE TO DoD IG AUDIT  
BUDGETING FOR SECONDARY SUPPLY ITEMS  
PROJECT No. 9LA-0061

A. BUDGET STRATIFICATION DEFICITS

FINDING -- Nonconcur in the estimated overstatement of the budget year deficit forecast. The audit disclosed that an engine blade had two nonexistent transfers of 10,000 each causing the on-hand inventory to be reduced by 20,000 units. The audit claimed a \$22.6M dollar overstatement. The true overstatement should only include the 20,000 units, not the entire buy deficit. In this case, the overstatement, at a maximum, should be valued at \$7.4M. The audit overestimated the overstatement by 33 percent and raises a question on the validity of the audits estimate that the overall Air Force budget year deficit was overstated by \$293.5M.

RECOMMENDATIONS -- Concur. HQ AFLC already has established parameters and priorities for review of stratification deficits. In addition, supervisory review staffs are required to certify accomplishment of reviews. This is documented in AFLCR 57-14, Appendix Three. Internal controls to ensure corrections are made are included in the Air Logistics Centers (ALCs) self-inspection program. We agree to review parameter limits for reasonableness. Review is estimated to be complete in time for 31 Mar 91 stratification processing.

B. BUDGET ADJUSTMENTS FOR SECONDARY SUPPLY ITEMS

FINDING -- Nonconcur. The estimated overstatement of obligation authority for consumable secondary items is inaccurate. See comments included in Recommendations 1a and 1b below.

RECOMMENDATION 1a -- Nonconcur. The spares requirement process is extremely dynamic; it is not possible to know exactly what item and in what quantity a specific item will be needed lead time away with great certainty. SA-ALC personnel deferred buys that, in their best item management judgement, were inappropriate to buy in FY 89 and FY90. This was done because of a long standing HQ AFLC policy not to buy safety level requirements for those items that have not experienced actual demands. It appears, however, that the auditor merely picked up the total adjustment made for base safety level and attributed it to the B-1. Other adjustments to base safety level were made besides those made to the B-1 safety level. Only \$6.1M had been deferred in a previous budget. The auditor was made cognizant of this fact well in advance of the publication of this draft audit. The auditor disagreed with our deferral because of the duplicative budgeting that appears to be occurring. The spares budget is not a line item controlled budget, but rather, a budget consisting of numerous item requirements that could possibly change up or down by the time execution occurs. When a requirement goes down in a spares budget, funds are spent for other requirements, as we are not fully funded. The audit does not consider that new item requirements could occur, only that requirements could be lower. The proposal to reduce Repairable Support Division (RSD) obligation authority by \$53.2M for B-1 base safety level is not reasonable.

RESPONSE TO DoD IG AUDIT  
BUDGETING FOR SECONDARY SUPPLY ITEMS  
PROJECT No. 9LA-0061 (continued)

We do concur in the reduction of RSD obligation authority of \$25.3M for not updating the budget request with the reduced Minuteman II replenishment spares requirement. However, it should be noted that the missile replenishment spares account is underfunded even with the overstatement.

RECOMMENDATION 1b -- Nonconcur. The audit recommends that the Air Force Stock Fund obligation authority for consumable items be reduced by \$8.1M due to an understated budget adjustment. The audit neglected to consider that HQ AFIC reduced the SAALC FY91 budget deficit by \$26.5M for overstated demands and stratification errors. The reduction included the \$8.1M for C-5A insurance items.

RECOMMENDATION 2 -- Concur. AFLCR 57-11, Appendix 4 requires that budget adjustments be made in the proper fiscal year and in accordance with existing regulations. AFLCR 57-11 also requires adequate documentation to support the budget adjustments. The March 1991 budget call, usually issued in April-May timeframe, will reemphasize the importance of complying with established guidance. Significant changes occurring after the budget cycle are routinely reported to HQ USAF.

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SUMMARY OF POTENTIAL MONETARY AND OTHER  
BENEFITS RESULTING FROM AUDIT

<u>Recommendation Reference</u>	<u>Description of Benefit</u>	<u>Amount and/or Type of Benefit</u>
A.1. and 2.	<u>Internal Control.</u> Provide better assurance that stratification budget year deficits are reviewed and results used in final deficit computations, thereby forming a more accurate basis for budget decisions by top level DoD management.	<u>Nonmonetary.</u> Stratification deficits form the basis upon which later budget decisions are made. The audit projected \$475.4 million in overstatements but did not review the impact overstatements would have had on later budget decisions by higher levels of management.
B.1.a. and b.	<u>Reduction in Obligational Authority.</u> Air Force budget adjustments overstated funding requirements for reparable items by \$53.2 million and consumable items by \$8.1 million.	<u>Questioned Costs.</u> One-time benefit of \$59.4 million to reduce Air Force Stock Fund obligational authority in FY 1991.
B.1.c. (Draft Report)	<u>Reduction in Obligational Authority.</u> Army Stock Fund obligational authority budget not supported for \$10 million adjustment, enables the DoD to reduce the Army obligational authority.	<u>Questioned Costs.</u> One-time benefit of \$10 million to reduce Army Stock Fund obligational authority in FY 1991.
B.2.	<u>Internal Control.</u> Provide better assurance that significant budget adjustments are made to appropriate fiscal years, consistent with current plans, and supported by adequate documentation.	<u>Nonmonetary.</u> The benefit would be one of potential questioned costs. Budget adjustments are a significant part of the total for secondary spares.

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Assistant Secretary of Defense (Production and Logistics),  
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Headquarters, U.S. Army Materiel Command, Alexandria, VA  
Headquarters, U.S. Army Aviation Systems Command, St. Louis, MO  
Headquarters, Communications-Electronics Command,  
Fort Monmouth, NJ  
Headquarters, U.S. Army Troop Support Command, St. Louis, MO

### Navy

Office of the Comptroller, Washington, DC  
Headquarters, Naval Air Systems Command, Washington, DC  
Headquarters, Naval Sea Systems Command, Washington, DC  
Headquarters, Naval Supply Systems Command, Washington, DC  
Aviation Supply Office, Philadelphia, PA  
Ships Parts Control Center, Mechanicsburg, PA

### Air Force

Deputy Chief of Staff, Logistics and Engineering, Washington, DC  
Headquarters, Air Force Logistics Command, Wright-Patterson  
Air Force Base, OH  
Ogden Air Logistics Center, Hill Air Force Base, UT  
San Antonio Air Logistics Center, Kelly Air Force Base, TX  
Warner Robins Air Logistics Center, Robins Air Force Base, GA

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