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Defense Logistics Agency's Warstopper Program

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Acronyms

DLA	Defense Logistics Agency
DSC	Defense Supply Center
PDAD	Program Description and Approval Document
ROI	Return on Investment



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

August 15, 2007

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Report on Defense Logistics Agency's Warstopper Program
(Report No. D-2007-116)

We are providing this report for information and use. We considered management comments on a draft of this report in preparing the final report.

Comments on the draft of this report conformed to the requirements of DoD Directive 7650.3 and left no unresolved issues. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Thomas S. Bartoszek at (703) 604-9619 (DSN 664-9619) or Mr. John W. Henry at (215) 737-3883 (DSN 444-3883). See Appendix D for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Wanda A. Scott", is positioned above the printed name.

Wanda A. Scott
Assistant Inspector General
Readiness and Operations Support

Department of Defense Office of Inspector General

Report No. D-2007-116

August 15, 2007

(Project No. D2006-D000LD-0096.000)

Defense Logistics Agency's Warstopper Program

Executive Summary

Who Should Read This Report and Why? DoD personnel and Government contractors who are involved in the Defense Logistics Agency's Warstopper Program should read this report. It discusses the execution and overall management of the Warstopper Program to satisfy requirements for sudden and sustained increases in production (surge and sustainment) of selected critical industrial and medical items.

Results. Conference Report 102-311, "National Defense Authorization Act for Fiscal Years 1992 and 1993," accompanied House Resolution 2100, "National Defense Authorization Act for 1992 and 1993," which became Public Law 102-190, "National Defense Authorization Act for 1992 and 1993" on December 5, 1991. The report identified potential "war stopper" items on the basis of experience during Operation Desert Storm. The items included nerve agent antidote auto-injectors; chemical protective overgarments and gloves; meals ready to eat; tray pack rations; combat boots, including cold weather boots; and barrier materials. Demand for these items was high in wartime but declined rapidly in peacetime. The Under Secretary for Acquisition in September 1992 stated that Defense Logistics Agency would be the principal agent for the Warstopper Program. Shortly thereafter, Congress created a separate Warstopper budget line to fund the preservation of critical industrial capabilities for selected items.

The Defense Logistics Agency's Warstopper Program generally has been successful in providing a stable industrial base for selected Warstopper items managed by the Agency. The Defense Logistics Agency increased industry's capacity to provide surge and sustainment of selected Warstopper items, such as chemical gloves and meals, ready to eat. However, the Defense Logistics Agency included items in the program that did not meet its criteria. As a result, the Defense Logistics Agency may have used scarce Warstopper funds for projects that should not have been included in the Warstopper Program and may have overlooked more deserving projects. We recommend that the Director, Defense Logistics Agency require the Warstopper Program Manager to clearly identify specific criteria for including commercial medical data and licenses, specify the contents of the Program Description and Approval Document, (a proposal to include a particular item); provide guidelines for calculating the potential return on investment associated with the acquisition of a prospective item, and formally document lessons learned. (See the Finding section of the report for the detailed recommendations.) Our review of the Managers' Internal Control Program did not identify any material management control weaknesses and was effectively functioning.

Management Comments. The Program Manager of the Warstopper Program (J-7), through the Director, Acquisition Management, Defense Logistics Agency, concurred with the recommendations in the draft report. Refer to the Finding section for a discussion of management comments and to the Management Comments section for the complete text of the comments.

Audit Response. Management comments are responsive to the recommendations contained in the draft audit report. The Program Manager of the Warstopper Program (J-7) stated that the recommendations are incorporated in the revised One Book chapter on managing the Warstopper Program that is currently in final coordination.

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Background

Congressional Guidance. Conference Report 102-311, “National Defense Authorization Act for Fiscal Years 1992 and 1993,” accompanied House Resolution 2100, “National Defense Authorization Act for 1992 and 1993,” which became Public Law 102-190, “National Defense Authorization Act for 1992 and 1993” on December 5, 1991. The report identified potential “war stopper” items on the basis of experience during Operation Desert Storm. These items, critical to the Services’ mission, are needed to meet wartime surge requirements, but their peacetime requirements are not sufficient to maintain an industrial capability. Among the items included as war stopper items were nerve agent antidote auto-injectors; chemical protective overgarments and gloves; meals ready to eat; tray pack rations; combat boots, including cold weather boots; and barrier materials. The conference report indicated that DoD should take the necessary steps to ensure the maintenance and stability of the industrial base for war stopper items. The report also indicated that the Secretary of Defense should prepare and submit a plan to the congressional defense committees no later than January 31, 1992, to meet the requirement. The Under Secretary for Acquisition in September 1992 stated that Defense Logistics Agency (DLA) would be the principal agent for the Warstopper Program.

Congress in FY 1992 then created a separate Warstopper budget line to provide funding for the preservation of critical industrial capabilities for selected items. Congress provided total funding from FYs 1993 through 2004 of \$433,906,942. For FYs 2005 and 2006, Congress allocated \$56,227,244 and \$48,465,044 respectively.

Warstopper Program. The Acquisitions Programs and Industrial Capabilities Division of the DLA J-7, Acquisition Management Directorate manages the Warstopper Program (the Division is referred to as the Warstopper Program Office throughout this report). The Warstopper Program Manager provided documentation on the development of the Warstopper Program from 1998 to the present, but there was no formal audit trail documenting the organizational stewardship of the funds from the program’s inception to 1998. DLA General Order 5-98, February 11, 1998, transferred management of the Warstopper Program to the Defense Logistics Support Command, which managed the program and established its policies and procedures. From 1998 to 2007, responsibility for the Warstopper Program transferred with successive reorganizations until General Order 4-07, March 4, 2007, established the Acquisition Management Directorate. That directorate included the Acquisitions Programs and Industrial Capabilities Division, which was given responsibility for oversight of the Warstopper Program.

Warstopper Process. In addition to the congressionally identified items, the Services may submit their unfunded war reserve requirements to the DLA Supply Centers responsible for the items.¹ Supply Center personnel determine whether the item meets the intent of the Warstopper Program and whether a surge and sustainment capability is needed. If so, Supply Center personnel determine whether the item is included in an existing contract and whether the contractor will provide

¹ Services submit requirements annually except for medical items, which are sent to DLA quarterly.

surge and sustainment capability at no cost. If the contractor agrees to provide surge and sustainment of the item at no cost, the contracting officer at the Supply Center modifies the contract to include a surge and sustainment clause. If not, DLA Supply Center personnel perform an industrial analysis when necessary for items other than studies, reports, and medical data. The industrial analysis validates requirements, reviews the commercial capacity to meet the requirements, suggests alternatives to meet the deficiency, recommends solutions, and identifies needed funding.

In addition to items proposed by the Services, Defense Supply Center personnel can identify potential critical items on the basis of high wartime demand. Supply Center personnel then inform the Services of these items, and Service personnel determine whether to include the items in their requirements submission for the Warstopper Program. When Defense Supply Center personnel receive a requirement submission, they prepare a proposal known as a Program Description and Approval Document (PDAD), which includes the reason for requesting Warstopper funds; the effect on the warfighter; a pre-investment calculation of return on investment (ROI), which is an estimated benefit; an acquisition strategy; and a funding profile projecting funding needs in current and outlying years. The DLA Warstopper Program Manager then reviews the PDAD and either approves or disapproves it. If it is approved, the Warstopper Program Manager provides funding on a service order to the requesting Defense Supply Center. A service order is a mechanism for transferring funds among DLA organizations. The Supply Center initiates the acquisition process by awarding a new contract or modifying the existing contract to include a surge and sustainment clause. See Appendix B for a flowchart of the Warstopper process.

Objectives

Our overall audit objective was to evaluate the effectiveness of the DLA Warstopper Program in meeting the needs of the Services for war reserve materiel by guaranteeing surge production capability from the industrial base. Specific objectives were to evaluate the process of identifying and selecting items for the Warstopper Program; the ability of industry to provide surge and sustainment for Warstopper items; the surge production benefits the Warstopper Program receives; lessons learned from providing items during Operation Iraqi Freedom and Operation Enduring Freedom; and the management control program as it relates to the overall objective. See Appendix A for a discussion of the scope and methodology and for prior coverage related to the objectives.

Review of Internal Controls

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures,"

August 28, 1996,² require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended, and to evaluate the adequacy of the controls.

We identified no major weaknesses in management controls within the Warstopper Program that related to meeting the needs of the Services for surge production capability. However, DLA needs to improve the controls over the selection process and conduct of studies of lessons learned from prior events. Recommendations contained in this report, if implemented, will improve the selection of Warstopper items and the management of the program.

² Our review of internal controls was done under the auspices of DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, and DoD Instruction 5010.40, "Management Control (MC) Program Procedures," August 28, 1996. DoD Directive 5010.38 was canceled on April 3, 2006. DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," was reissued on January 4, 2006.

Management of the Defense Logistics Agency's Warstopper Program

The DLA Warstopper Program Manager took effective action to guarantee industry's ability to provide surge and sustainment for selected Warstopper items, benefiting the warfighter. However, some investments funded by the Warstopper program are questionable, and others do not meet published criteria. These conditions occurred because DLA did not provide the Supply Centers with written guidance that clearly defined the selection criteria for potential Warstopper investments and specify how to prepare requests for Warstopper funds. In addition, personnel did not prepare a lessons learned study from previous operations. Consequently, the intent of the program envisioned by Congress—selecting the most deserving items for the Warstopper Program—may not be met.

Criteria

DLA Warstopper Guidance. DLA issued the “Defense Logistics Support Command Memorandum DLSC-P,” October 21, 1998, to provide basic guidance to Supply Center procurement managers on the Warstopper Program. The memo states that the primary purpose of the Warstopper Program is to fund Warstopper investments that satisfy a wartime surge. Before using Warstopper funds, procurement managers must consider whether a potential investment is:

- critical to the conduct or sustainment of combat operations,
- based on wartime surge and sustainment requirements,
- focused on expanding, sustaining, or recreating industrial capability and not on the procurement of war reserve inventories,
- made for unique products and industrial capability,
- the most cost- and mission-effective solution to guarantee the availability of critical product or industrial capability, or
- made for the purchase and storage of finished inventory only as a last resort.

The memorandum states that inventory reduction is a key objective. Therefore, appropriate investments usually are items with limited shelf life that the contractor can rotate.³ In addition, the memorandum requires DLA Supply Center personnel to

³ Items are rotated through inventory to perpetually extend the life of the investment.

prepare a business case (the PDAD) before requesting approval of potential Warstopper investments from the Warstopper Program Manager.

The memorandum cites a letter from the Under Secretary of Defense for Acquisition and Technology dated April 17, 1998, emphasizing the need to perform a rigorous analysis before making investments to preserve industrial capabilities.

DLA “The One Book” Guidance. DLA Directive 5025.30, “The One Book,” December 9, 2003, standardizes and streamlines DLA policies, processes, and procedures. It includes a chapter titled, “Industrial Capabilities Program, Manage the Warstopper Program.” The One Book states that the intent of the Warstopper Program is to preserve the industrial base for critical warfighting items, the demand for which during peacetime is insufficient to meet wartime needs. Investments are for accelerating production of critical items and maintaining critical industrial capabilities. Furthermore, investments are intended as a cost-effective alternative to the procurement and storage of war reserve materiel. The investments include items that meet the Warstopper criteria as spelled out in the 1998 Defense Logistics Support Command Memorandum or are congressionally required. In general, these items are mission critical and have low peacetime and high wartime demand, a long lead time, or a short shelf life.

Acquisition Guidance. The DoD Defense Acquisition Guidebook, Version 1.6, July 24, 2006, is designed to complement policy documents by providing discretionary best practices to acquisition officials, who should tailor the information to their programs’ needs. Studies of lessons learned give the program manager a tool to help identify potential areas of risk associated with a program. Lessons learned documents tell what worked and what did not work in the past, in the hope that a future program can avoid similar pitfalls.

Surge and Sustainment Capability

The DLA Warstopper Program Manager took effective action to ensure the surge and sustainment capability of the industrial base for selected critical Warstopper items.

According to the FY 2005 DLA Warstopper Annual Report, November 30, 2005, the Warstopper Program preserved the nerve agent antidote auto-injector and chemical glove industries, improved the subsistence (rations) industry, and refashioned medical readiness. For example, Supply Center personnel reported in their PDAD that the production requirement for nerve agent antidote auto-injectors is 950,000 units within 142 days in peacetime, and 5 million units in wartime. The Warstopper contract acquired access to excess plant capacity and mandated the rotation of components for auto-injectors that the Supply Center purchased and the contractor stored for contingencies. Without the Warstopper investment, the Services would have to build and stock their entire wartime requirement over a 2-year period.

During FY 2005, DLA provided funding on 25 Service Orders. We judgmentally selected 12 contracts with FY 2005 funding of \$17.7 million awarded by the Supply

Centers that represented 5 of the 25 Service Orders. We reviewed the 12 contracts shown in the following table to determine their applicability to the program and the contractor's ability to provide the materiel and services required.

Contracts Reviewed During the Audit

	<u>Contract Number</u>	<u>Date of the Contract</u>	<u>Item</u>	<u>Estimated Total Value (\$ thousands)</u>	<u>Warstopper FY 2005 Value (\$ thousands)</u>
1	SP0441-05-D-1652	Sept. 28, 2005	Lithium batteries	6,452	6,452
2	SP0441-05-D-1666	Sept. 28, 2005	Lithium batteries	3,077	3,077
3	SP0430-04-D-1009	Sept. 3, 2004	Direct-current motors	866	38
4	SP0500-04-D-0239	Feb. 13, 2004	Barriers	164,044	3,000
5	SP0407-05-D-0464	Dec. 27, 2004	Windshields	10,261	1,784
6	SP0200-98-F-FD83	Sept. 30, 1998	Bandages	1,988	97
7	SP0200-05-C-7704	Sept. 28, 2005	Pharmaceutical sales data	3,419	631
8	SP0200-05-C-7705	Sept. 28, 2005	Medical/surgical sales data	3,335	645
9	SP0200-02-D-3007	Sept. 10, 2002	Cataloging, classification	3,046	784
10	SP0200-01-D-3001	Sept. 26, 2001	Pharmaceuticals	5,708	510
11	SP0200-01-D-3916	Sept. 28, 2001	Blood-testing kits	9,100	616
12	SP0200-02-D-8018	Sept. 25, 2002	Portable ventilators	7,977	63

Appendix C describes the 12 contracts. Of the 12, 8 required the contractor to maintain a level of inventory in the event that DLA invoked the surge and sustainment clause, and 4 did not. We visited four of the eight prime contractors and one subcontractor. We conducted a physical inventory and verified that the amount of inventory on hand could meet the initial surge and sustainment contract requirements. For example, our review of contract number SP0200-98-F-FD83, September 30, 1998, awarded to Elwyn Industries, determined that the contract required the contractor to have sufficient raw material on hand by May 1999 to deliver 320,000 first-aid camouflage bandages and 1,332,529 camouflage compressed muslin bandages. Warstopper funding for this contract for FY 2005 was \$96,970. We visited Elwyn in September 2006 and conducted a physical inventory for 7 of the 15 line items of raw materials used in the production of bandages. We identified the amount of raw material needed to produce the required

number of finished items; counted, weighed, and measured the raw material on hand; and determined that raw material quantities were sufficient to meet the surge and sustainment requirements.

Benefits of the Warstopper Program

The DLA Warstopper Program Manager funded items that generally provided the warfighter significant benefits.

The 2005 DLA Annual Warstopper Report detailed monetary benefits and improvements in readiness. From FYs 1993 through 2005, the Warstopper Program invested about \$490 million to purchase access to inventory. If the Services had purchased and stocked the assets, the cost would have been \$3.2 billion. This investment resulted in a reported cost avoidance of \$2.7 billion, of which \$1.7 billion was attributed to medical readiness. The Warstopper Program Office used two methods to compute the cost avoidance, and a third to compute benefits related to readiness. All three methods used cost information available at the end of the fiscal year for the annual reporting. The first method compared the cost of buying and storing the required item with the cost of pre-positioning raw material or subassemblies at the manufacturer's plant. The second method compared the cost of buying and storing the required item with the cost of Government-furnished materiel and contractor management fees. The third method compared the cost of buying and storing the required item with the cost of increasing a contractor's production capacity to meet the wartime surge requirement.

During the audit, we met with officials from Bearing Point, a support contractor for the Warstopper Program, and discussed in detail the calculations used in the annual report to identify benefits derived from the investments. We also obtained copies of spreadsheets used in the computation of benefits that we reviewed. The benefits received are shown in the Annual Report as an actual return on investment (post-ROI) for each line item. The post-ROI calculation shown in the Annual Report uses updated cost information, which is different from the pre-ROI computed as part of the PDAD. We verified the post-ROI computations for three Warstopper investments, including Ultralife lithium batteries, camouflage bandages, and transmission races. For example, the report stated that the Army required 940 transmission races to meet surge and sustainment requirements for the Bradley Fighting Vehicle System. The manufacturer identified a long lead time of about 41 weeks for the specialty steel used to produce the races. Bearing Point's analysis showed that the purchase and storage of the transmission race would cost about \$2.59 million. The purchase and pre-positioning of the specialty steel would cost about \$310,000. The benefit derived from having the long lead time material available resulted in a post-ROI of 8.4 to 1.⁴ We also reviewed two of the three methodologies used by the Program Office and determined that the methodologies provided a reasonable estimate of the benefits derived from each Warstopper investment.

⁴ The post-ROI was calculated by dividing the cost to purchase and store the race (\$2,589,574 million) by the cost of purchasing and pre-positioning the specialty steel (\$309,699).

Selection of Warstopper Investments

Some Warstopper investments in industrial and medical items were questionable. Under the 12 contracts we reviewed, we found that the Warstopper Program provided funding for an industrial motor and medical items that did not meet the intent of the Warstopper Program.

Industrial Items. The Defense Supply Center (DSC) Richmond awarded contract SP0430-04-D-1009, September 3, 2004, valued at \$865,650, of which \$37,810 was FY 2005 funding, to Motor Technology for the purchase of direct-current motors that the Services use in aircraft such as the Sea Sprite helicopter. The contract required the delivery of 110 motors within 90 days of invoking the surge and sustainment clause. To meet the surge and sustainment schedule, the contractor had to build the motors to about 80-percent completion. The additional 20 percent involved painting, testing, packaging, and shipping the motors. The motors do not have a limited shelf life.

DLA officials informed us that they included the motors in the Warstopper Program because they were unable to reprogram the funds to medical candidates before the end of the fiscal year. In addition, the PDAD showed the motors had a long lead time and a pre-ROI of 1.04 to 1.00.⁵

Both The One Book and the DLA Memorandum of October 21, 1998, allow investments for items that have a limited shelf life. We question whether the motors should be funded under the Warstopper Program because the motors do not have a limited shelf life and are about 80-percent complete. In general, Warstopper items are mission critical, have low peacetime and high wartime demand, a long lead time, or a short shelf life. In addition, DLA guidance stresses that appropriate investment in finished goods usually involves items with a limited shelf life. Scarce Warstopper funds should not be used for this type of investment.

Medical Items. The Warstopper Program Manager approved a PDAD in November 2004, titled "Pharmaceutical Corporate Exigency Contracts." The PDAD included pharmaceutical items that are commercially supportable and not militarily unique. The items are directly applied in the treatment of the majority of expected wartime casualties or patients with illnesses. The items are needed to save or sustain life or limb and to prevent or reduce impairment or disease, including the effects from biological or chemical warfare. The PDAD did not identify specific pharmaceutical items, instead allowing Supply Center personnel to use their professional judgment in selecting the items.

DSC Philadelphia awarded contract SP0200-01-D-3001 on September 26, 2001, valued at \$5,707,780, of which \$509,587 was for FY 2005 funding, to Johnson & Johnson on behalf of Ortho-McNeil Pharmacy, Inc., for access to selected pharmaceutical items. The basic contract awarded in 2001 included access to five types of antibiotic items. From the award of the basic contract through

⁵ The pre-ROI was calculated by dividing the standard price of the motor (\$39,451.11) by the cost of the raw material, labor, and management fees associated with assembling the motors to 80-percent completion (\$37,810.00).

September 2006, contracting officials issued 22 modifications, expanding the products covered to 41 pharmaceutical items, including 8 items such as diaphragms and oral contraceptives. Although not used to treat expected wartime casualties or patients with illnesses or to sustain life or limb, birth control items could prevent or reduce impairment or disease. However, we do not believe that birth control items meet the intent of the PDAD or the intent of the Warstopper Program.

Selection Guidance for the Warstopper Program

Some investments funded by the Warstopper program did not meet published criteria. DLA did not provide the Supply Centers with written guidance that clearly defined the selection criteria for Warstopper investments and specified how to prepare requests for Warstopper funds.

Updating Criteria for Warstopper Investments. Of the 12 contracts reviewed, 2 provided funding for the acquisition of commercial pharmaceutical and medical/surgical sales data, and 1 provided for access to a license to obtain product classification, nomenclature standardization, and functional equivalents identification for medical/surgical items. DSC Philadelphia personnel awarded the sales data contracts to IMS Health in September 2005. Contracts SP0200-05-C-7704 (for \$631,284) and SP0200-05-C-7705 (for \$645,330) provide commercial sales data including a list of items arranged by national drug code or manufacturer's part number, and nomenclature. The contractor obtains the data from several sources, such as pharmacies, mass merchants, drug wholesalers, chain drugstores, hospitals, and Federal medical facilities. DSC Philadelphia personnel informed us that they use the data to identify current pricing, packaging, item availability, and related trends within the medical community. They enter the data into their Readiness Management Application database, which gives users information on what is needed for contingencies and who supplies the required material.

DSC Philadelphia awarded the third contract, SP0200-02-D-3007, valued at \$3,045,917, of which \$784,380 was FY 2005 funding, to Cardinal Health on September 10, 2002, for a license to cross-reference commercial item numbers to national stock numbers, or to assign national stock numbers to unclassified items, and to identify potential substitute items.

The three contracts enable DLA to identify, classify, and determine equivalents for medical items. On the basis of current DLA guidance, the three contracts did not meet the Warstopper criteria. However, congressional guidance directed DoD to take the necessary steps to ensure the maintenance and stability of the industrial base for critical Warstopper items. Also, a report by the General Accounting Office (now the Government Accountability Office), GAO-02-650, "Defense Inventory: Improved Industrial Base Assessments for Army War Reserve Spares Could Save Money," July 2002, cited the importance of current industrial capability data and the ability to assess the industrial base capability. DLA should include this criterion in The One Book guidance because the medical data and license do not meet current Warstopper criteria.

Preparing the Program Description and Approval Document. The One Book states that Supply Center personnel must complete a PDAD and submit it, along with supporting documentation, to the Program Manager when requesting Warstopper funding. However, The One Book provides little guidance on specific elements to include in each PDAD. The Warstopper Program Manager informed us that he selectively reviews the content of each PDAD for weighting factors including return on investment (pre-ROI calculation), criticality, effect on readiness, and risk (stability of the industry, item longevity, and relevance).

Pre-Investment Return on Investment. ROI calculations compare the cost of acquiring and storing materiel with the cost of investing in the industrial capacity to produce the materiel (the Warstopper solution). The Program Manager uses the pre-ROI calculation to make an initial go/no-go decision. If the pre-ROI ratio is greater than 1, the Program Manager further evaluates the proposed investment. If the pre-ROI is less than or equal to 1, the Program Manager considers the investment only if it is congressionally required.

Our review disclosed that the pre-ROI calculations in the PDAD provided by the Defense Supply Centers were neither consistent nor accurate. We reviewed 10 PDADs containing 14 pre-ROI calculations; 2 of the PDADs contained multiple pre-ROI calculations. Of the 14 calculations, 4 were correctly computed, 1 had insufficient data to analyze, 7 were missing components (storage costs or management fees) or contained an error in the calculation, and 2 were for medical data and licenses for which the Program Manager did not consider the pre-ROI relevant. Of the seven with missing components or errors in calculations, Supply Center personnel understated five pre-ROI calculations and overstated two. For example, on the lithium battery PDAD (contract SP0441-05-D-1652), the computed pre-ROI was 1.96 to 1. Our review showed that the pre-ROI was actually overstated and should have been 1.81 to 1. The pre-ROI was overstated because the computation did not include the annual storage handling fee. We recognize that the overstatement was only 8 percent and did not affect the investment decision; however, investments made on the basis of calculations that were missing data could affect future Warstopper investment decisions.

Criticality and Readiness Factors. The other weighting factors that the Warstopper Program Manager uses are the criticality of the item, its effect on readiness, and the risk involved (stability of the industry, item longevity, and relevance). The Warstopper Program Manager informed us that he uses his professional judgment in evaluating the other weighting factors. He does not formally document the rationale for measuring criticality and readiness. However, his signature on the PDAD approves it as a Warstopper investment.

Because of the errors in computing the pre-ROI and the lack of criteria for measuring criticality and readiness, the Warstopper Program Manager may have overlooked deserving projects and funded less deserving projects. Officials must take action to define the methodology for the calculation of the pre-ROI included in the PDAD and develop tools for measuring criticality and the effect on readiness. Officials must publish guidance to identify specific criteria used in the selection process, including the need for up-to-date medical data and licenses; define the

methodology for calculating the pre-ROI included in the PDAD; standardize PDAD contents; and provide weighting factors such as criticality and readiness for prioritizing similar investment candidates.

Current Actions by Warstopper Program Office

In March 2007, Warstopper Program officials stated that in March 2006 they issued a draft PDAD to the Supply Centers. The draft provided the format and content for requesting Warstopper funding, the criteria used to justify the proposed investment, assumptions made during analysis, and an exit strategy to recover all or a portion of the Government-furnished property when the contract expires or the Government terminates it. The officials received comments from the Supply Centers, are waiting for comments from their financial group, and will work with the legal office to incorporate the comments in the guidance. In addition, the officials are revising The One Book. We believe the guidance will provide Supply Center personnel with clear and comprehensive instructions for preparing PDADs. Officials need to issue the draft PDAD guidance in final form and revise The One Book to include the recommendations in this report.

Lessons Learned

Warstopper officials informed us they did not conduct formal studies of lessons learned to determine whether contractors were able to meet surge requirements for Warstopper items during Operation Enduring Freedom and Operation Iraqi Freedom. The DoD Defense Acquisition Guidebook states that lessons learned are a tool that the program manager may use to identify potential areas of risk associated with a program, system, or process. Officials from the Warstopper Program Office did not provide an explanation for not conducting studies of lessons learned. At our request, the Program Manager compiled a list of contracts that surged recently. As an example, he noted that the surge to outfit the Navy hospital ship *USNS Comfort* filled 90 percent of the items required. However, he did not have documentation to support the cited percentage. Although not currently part of the evaluation process, identifying investments that failed to meet surge requirements and the causes of the failures could aid in identifying and determining which surge and sustainment items the Warstopper Program Office should continue to fund. Further, studies of lessons learned could help determine the need to fund other investments to meet requirements. Officials should prepare a lessons learned report on recent experiences in areas of conflict and natural disasters and use the results to help in making future investment decisions.

Conclusion

The DLA Warstopper Program Office took action to ensure that industries had the ability to provide surge and sustainment production of selected Warstopper items and that the warfighter received benefits from the program. However, the Warstopper Program Office must improve the process for identifying and selecting

investments by providing more detailed guidance that clearly defines the process, cites the criteria used, standardizes the contents of a PDAD, and gives the methodology for calculating the pre-ROI used in the PDAD. More detailed guidance will provide Defense Supply Center personnel with a better understanding of the identification and selection process, criteria, PDAD format, and pre-ROI calculations. In addition, guidance will enhance the selection process by allowing Warstopper personnel to approve only high priority investments. Performing studies of lessons learned can further aid in identifying shortfalls in the Warstopper Program. Finally, guidance will ensure that the Warstopper program continues to meet the intent of Congress to guarantee industry's surge capability for mission-critical items with low peacetime and high wartime demand, long lead time, or short shelf life.

Recommendation, Management Comments, and Audit Response

We recommend that the Director, Defense Logistics Agency require the Warstopper Program Manager to publish a revised Defense Logistics Agency Directive 5025.30, The One Book, that:

- 1. Identifies specific criteria to be used in the selection process, including a provision for medical commercial data and licenses to exploit the data.**
- 2. Standardizes the contents of the Program Description and Approval Document and establishes weighting factors for prioritizing similar investment candidates.**
- 3. Defines the methodology for calculating the pre-return on investment included in the Program Description and Approval Document.**
- 4. Requires studies of lessons learned to help identify shortfalls in the Warstopper Program.**

Warstopper Program Manager Comments. The Program Manager for the Warstopper Program, through the Director of Internal Review, DLA, and approved by the Director, Acquisition Management, DLA, concurred with the recommendations.

Audit Response. Management comments are responsive to the recommendations contained in the draft audit report. The Program Manager of the Warstopper Program (J-7) stated that the recommendations are incorporated in the revised One Book chapter on Managing the Warstopper Program, currently in final coordination and expected to be completed by August 30, 2007. Specifically, the Program Manager indicated that he revised paragraphs 4.6.1.5.1.1 through 4.6.1.6.1.4, paragraph 4.6.6.4, and Section 5 of the One Book to fulfill the recommendations.

Appendix A. Scope and Methodology

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our finding and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objectives.

We evaluated the effectiveness of the DLA Warstopper Program in meeting the needs of the Services for war reserve materiel by guaranteeing surge production capability from the industrial base. Specifically, we evaluated the ability of industry to provide surge and sustainment for Warstopper items and the benefits the program receives from surge production.

We interviewed personnel responsible for implementing and monitoring the Warstopper Program, including the Warstopper Program Manager, Contracting Officers and Program Managers from the Defense Supply Centers in Philadelphia and Richmond, and contractor personnel supporting the DLA Warstopper Program Office. In addition, we interviewed the Warstopper contractors and subcontractors involved with 8 of the 12 contracts that we judgmentally selected for review.

We reviewed the Warstopper Program history and goals as discussed in the FY 2005 DLA Warstopper Program Annual Report as well as in DoD Instructions and Directives, including The One Book. Additionally, we reviewed Conference Report 102-311, “National Defense Authorization Act for Fiscal Years 1992 and 1993,” accompanying House Resolution 2100, “National Defense Authorization Act for 1992 and 1993,” which became Public Law 102-190, “National Defense Authorization Act for 1992 and 1993” on December 5, 1991. The law requires “the Defense Department to take the necessary steps to ensure the maintenance and stability of the industrial base for critical ‘war stopper’ items” and gives the specific Warstopper Program criteria used to select items for the Warstopper Program. To determine whether DoD took the necessary steps, for each sample contract, we analyzed the 2005 Warstopper database, the industrial base analyses, the PDAD, the solicitation, the proposal, the contract award and modifications, the price negotiation memorandum, statements of work, and the results of any site visits and inventory counts. We also visited contractor facilities to ensure the contractor met the contractual requirements, maintained the required materiel on hand and in good condition, and separated the materiel from the contractor’s commercial inventory when required.

We discussed the Warstopper Program Office’s procedures for determining lessons learned from prior conflicts and natural disasters and whether surged contracts successfully met surge requirements. Also, we discussed whether DLA included items in the Warstopper Program on the basis of past surge problems.

We performed this audit from December 2005 through May 2007 in accordance with generally accepted government auditing standards. We suspended the audit for 3 months from January to April 2006.

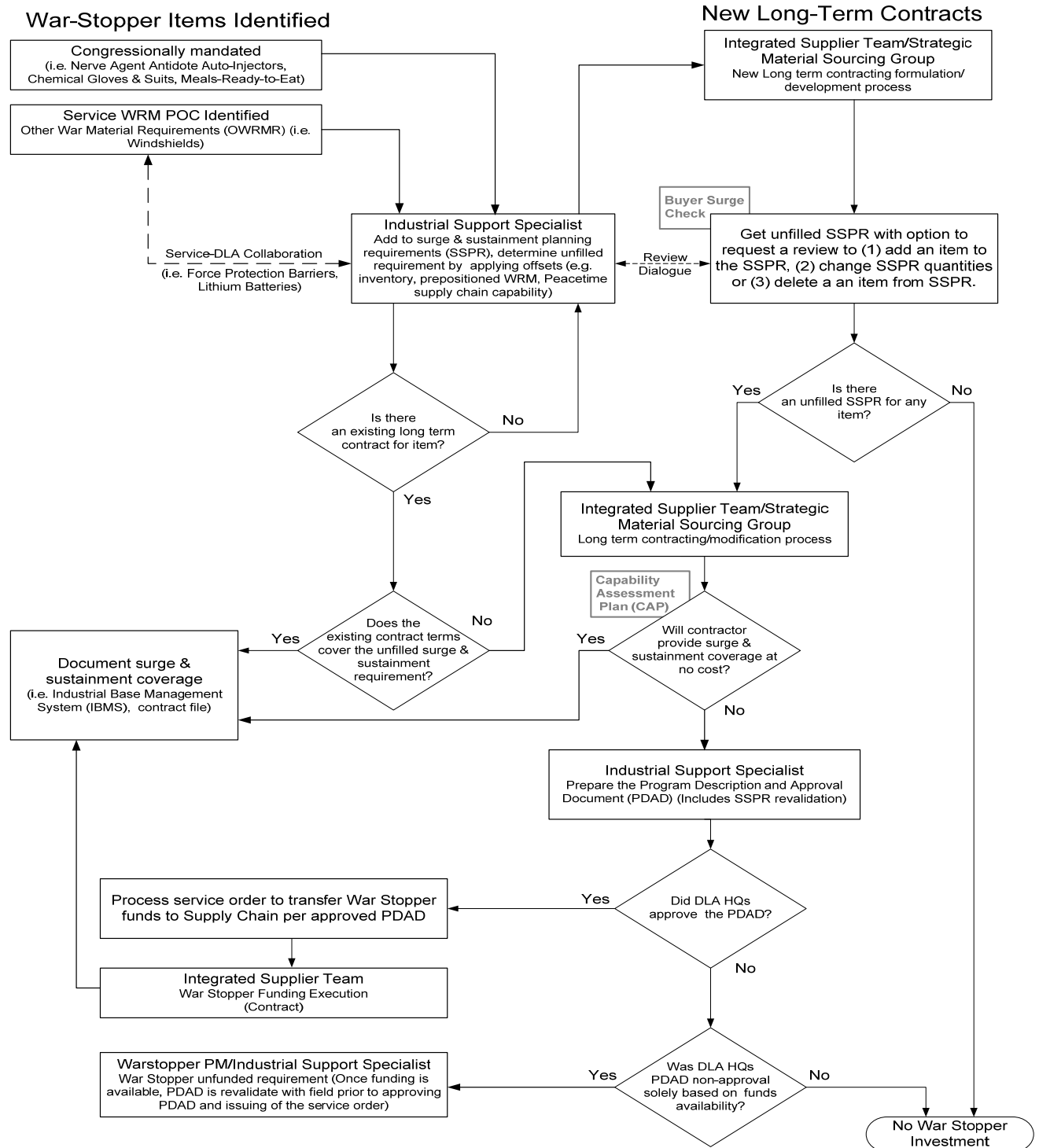
Our scope was limited to contracts with FY 2005 funding only. We examined Medical Expenditures (\$35.6 million), Aviation and Space Support (\$11.7 million), and Construction and Equipment (\$3.3 million) contracts. We did not examine Warstopper funding related to contracts for items managed by DSC Columbus, for clothing and textiles or subsistence items managed by DSC Philadelphia, or for DLA Headquarters Support, all of which totaled \$5.7 million in FY 2005.

Use of Computer-Processed Data. We did not use computer-processed data to perform this audit.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD high-risk areas “DoD Approach to Business Transformation: Supply Chain Management and Contract Management.”

Prior Coverage. Government Accountability Office, Report No. GAO-02-650, “Defense Inventory: Improved Industrial Base Assessments for Army War Reserve Spares Could Save Money,” July 2002

Appendix B. Warstopper Process



Source: Flowchart submitted by the Warstopper Program Office

Appendix C. Contract Descriptions

1. **Contract SP0441-05-D-1652, awarded to Saft America Inc. on September 28, 2005, was valued at \$6,451,962 and provided for lithium batteries, used in numerous weapon and communication systems.** The batteries are a low peacetime/high wartime demand item. With the Warstopper investment, the contractor will significantly reduce the shortfall that could occur during a conflict or natural disaster. Inadequate supplies during the ground operations of Operation Iraqi Freedom had the potential to stall offensives and change battlefield tactics. Therefore, DLA used Warstopper funds to reduce the ramp-up time for production and better meet the surge and sustainment schedule. Phase I of the investment consisted of pre-positioning raw materials and components. Phase II required purchase of additional raw materials and new production equipment. The exit strategy consisted of rolling over the equipment to follow-on contracts and abandoning the equipment in place when fully depreciated.

2. **Contract SP0441-05-D-1666, awarded to Ultralife Batteries Inc. on September 28, 2005, was valued at \$3,076,870 and also provided for lithium batteries.** DLA made the investment to pre-position critical materials with long lead times and subassemblies, and to purchase equipment and services to reduce production lead time. The Warstopper investment accomplished the following: pre-positioning of raw materials (\$1.8 million), expanding the contractor's facility (\$539,000), implementing a quality-control program (\$466,000) and a statistical process control program (\$149,000), and implementing a lean manufacturing program (\$169,000). The contractor will receive distribution instructions for the equipment, materials, and subassemblies at the end of the contract.

3. **Contract SP0430-04-D-1009, awarded to Motor Technology Inc. on September 3, 2004, was valued at \$865,650 (of which \$37,810 was for FY 2005) and supplied DoD with a direct-current motor.** The motors are used on the Sea Sprite, Cobra Attack, HH-60, and search and rescue helicopters. DLA included this item in the Warstopper Program because, without the investment, the contractor would be unable to meet the surge and sustainment schedule. DLA used Warstopper funding to enable the contractor to meet its surge and sustainment schedule.

4. **Contract SP0500-04-D-0239, awarded to Hesco Bastion Ltd. on February 13, 2004, was valued at \$164,044,369 (of which \$3 million was for FY 2005) and provided for the pre-positioning of textile and steel material for force protection bastions.** The contractor is the sole-source vendor for this critical item. Without the Warstopper investment, the contractor would be unable to meet the surge and sustainment schedule. An industrial study determined that Warstopper funding for pre-positioning the materiel would provide about 58 percent of the surge and sustainment requirements.

The bastion is an effective anti-terrorism and force protection barrier consisting of a prefabricated, multicellular system made of a welded steel-wire mesh, heavily galvanized, with a nonwoven geotextile insert. The bastions can be built to any required length or height. An industrial study determined that long lead time associated with raw materials constrained the contractor's ability to transition from

peacetime to wartime production. The Berry Amendment, which required textile to be purchased from domestic sources, was the reason for the excessive lead time for the textile.

5. Contract SP0407-05-D-0464, awarded to PPG Aerospace Transparencies on December 27, 2004, was valued at \$10,260,675 (of which \$1,784,130 was for FY 2005) and provided for the purchase of an additional Nesatron chamber to increase production of Nesatron-coated windows used in UH-60 Blackhawk and AH-64 Apache Helicopters. The contractor is the only available source for the windshields. Without the Warstopper funding, the contractor would be unable to meet the surge and sustainment schedule. With the investment, the contractor will significantly reduce the number of backorders that would result without the investment.

The coating provides uniform de-icing and defogging capability through electrically heated systems. DLA determined that wartime demand far outstripped production capability and resulted in significant shortfalls. The transition from peacetime to surge production was constrained by the capacity of the Nesatron chamber. DLA decided to fund the construction of an additional Nesatron chamber with the option to sell it to the contractor at fair market value at the end of 5 years. This added capacity would allow DLA to meet the current surge demand requirements, recover from the accumulated backorders, and reestablish a safety level for the windshields.

6. Contract SP0200-98-F-FD83, awarded to Elwyn Industries on September 30, 1998, was valued at \$1,987,571 and provided for the pre-positioning and rotation of raw materials for camouflaged bandages. The contract was originally a 5-year contract, but was extended through option year 8. The investment for FY 2005 was \$96,970 and represented storage fees to include the rotation of stocks with limited shelf life. The bandages have a low peacetime/high wartime demand and are militarily unique. Without these camouflaged bandages in the field, our fighting forces run the risk of having to use white bandages, thus compromising their strategic location and exposing them to potential discovery by unfriendly forces. Storing raw material used to produce certain bandages ensures the contractor can meet more mobilization demands.

7. Contract SP0200-05-C-7704, a 5-year contract (base with 4 option years) awarded to IMS Health Inc. in September 2005, was valued at \$3,419,236 and provides for the purchase of commercial pharmaceutical sales data. The investment for FY 2005 totaled \$631,284. The data provide insight into pharmaceuticals sold in the commercial healthcare industry. The data are used in the Medical Commercial Product Visibility system for market research and include sales levels and volumes of pharmaceutical products and product flow in certain geographic locations. The information allows DLA to assess the ability of the wholesale medical system to support pharmaceutical contingencies. It is a way to stay abreast of what is happening in the medical field, and it helps the user monitor trends in prices and demand for commercial pharmaceutical sales.

8. Contract SP0200-05-C-7705, a 5-year contract (base plus 4 option years) awarded to IMS Health Inc. on September 2005, was valued at \$3,335,140 and provides for the purchase of commercial medical/surgical sales data. The contractor gathered the data from manufacturers and distributors to analyze commercial sector ability to support all medical/surgical readiness items. The investment for FY 2005 totaled \$645,330. This Warstopper investment is used in the Medical Commercial Product Visibility system and provides information on medical/surgical items and quantities produced, stored, and sold, which is critical for surge and sustainment planning for the entire medical community. The data allow DLA to assess the wholesale medical system's ability to support medical/surgical contingencies.

9. Contract SP0200-02-D-3007, a 4-year contract (base plus 3 option years) awarded to Cardinal Health on September 2002, was valued at \$3,045,917 (of which funding for FY 2005 totaled \$784,380) and provided for additional commercial medical product cataloging data and product classification for identifying equivalent products. The ability to see what is actually being produced, stored, and sold in the commercial sector, as well as what equivalent products are available, allows the medical community to assess the ability of the wholesale medical system to support contingencies. Each month, the contractor provides equivalency data to DSC Philadelphia personnel, who load the data into the Distributions and Pricing Agreements application, which feeds the Medical Commercial Product Visibility system. The system provides a clear and current picture of industry's capability to support the readiness mission and provides usage and availability data that DLA can compare with the Services' requirements. The system also provides data mapping to cross-reference DoD materiel identification numbers to commercial materiel identification numbers.

10. Contract SP0200-01-D-3001, a 10-year contract (a pharmaceutical Corporate Exigency Contract for base year plus 9 option years) awarded to Johnson & Johnson on behalf of Ortho-McNeil on September 2001, was valued at \$5,707,780 (of which funding for FY 2005 totaled \$509,587) and provides access to the contractor's pharmaceutical inventory. The bulk of the pharmaceuticals meet the following Warstopper Program criteria: items have low peacetime/high wartime demand; items are critical to the conduct or sustainment of combat operations; items are available for surge wartime demand; and items have a short shelf life. The contractor's inventory under the contract includes antibiotics, anti-fungal medicine, analgesics, and contraceptives. The contract is flexible in allowing the Services to add or delete pharmaceutical items as they deem necessary.

11. Contract SP0200-01-D-3916, a 10-year contract (base plus 9 option years) awarded to Abbott Laboratories on September 2001, was valued at \$9,100,000 (of which funding for FY 2005 totaled \$615,656) and provides access to inventory of military blood-testing kits, cartridges, and peripherals. The item is a hand-held blood-testing kit that performs a range of blood gas, electrolyte, and chemistry, immunoassay, and coagulation tests in the field, with fast, accurate results. The item is a forerunner in this type of point-of-care, hand-held blood analyzer and meets the following Warstopper criteria: a truly unique product; a product critical to the sustainment of combat operations; and a product with low peacetime/high wartime demand. The contract allows for a ready-to-ship inventory for the Services' surge requirements without the lead time required to build the

military-specific Hardigg cases for the analyzer. The contract is also flexible in allowing for the upgrade to the newest analyzer, providing the Services with the latest technology and avoiding storage of obsolete inventory.

12. Contract SP0200-02-D-8018, a 5-year equipment Corporate Exigency Contract (base plus 4 option years) awarded to Impact Instrumentation Inc. in September 2002, was valued at \$7,976,796 (of which funding for FY 2005 totaled \$62,543) and provides access to contractor-furnished material and pre-positioning of Government-furnished material for portable ventilators.

The ventilator is unique, portable, and air certified for both fixed- and rotary wing aircraft. The contractor manufactures in-house 80 percent of the parts used to assemble the ventilator. The access purchased increases the capability of DLA to support wartime requirements.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Director, Acquisition Resources and Analysis
Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director, Program Analysis and Evaluation
Director, Defense Procurement and Acquisition Policy

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Combatant Command

Inspector General, U.S. Joint Forces Command

Other Defense Organizations

Defense Logistics Agency
Director, Acquisition Management
Division Chief, Acquisition Programs and Industrial Capabilities
Warstopper Program Manager

Non-Defense Federal Organizations

Office of Management and Budget

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement,
Committee on Oversight and Government Reform
House Subcommittee on National Security and Foreign Affairs,
Committee on Oversight and Government Reform

Defense Logistics Agency Comments



IN REPLY
REFER TO

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD
FORT BELVOIR, VIRGINIA 22060-6221

EXECUTIVE SUMMARY

MEMORANDUM FOR DIRECTOR, INTERNAL REVIEW OFFICE

FROM: J-74

Prepared by: Luis Villarreal/J-74/767-1427/June 7, 2007

SUBJECT: Department of Defense (DOD) Inspector General (IG) Audit of Warstopper Program

PURPOSE: Respond to Report Tasker dated June 4, 2007

DISCUSSION:

- DOD IG provided a draft report of their audit of the Defense Logistics Agency (DLA) Warstopper Program (TAB B).
- J-7 concurs with the recommendations from the DOD IG draft report
- IG recommendations are incorporated in the Industrial Capability – Warstopper Program Management One Book Chapter presently in final coordination (TAB C).

RECOMMENDATION: Director, Internal Review forward DLA comments and estimated completion dates to the DOD IG (TAB A).

COORDINATION: TAB D

Approved by: Claudia S. Knott, Director, Acquisition Management

A handwritten signature in black ink, appearing to read "Claudia S. Knott".

Recommendations From The DOD IG's Proposed Report
Defense Logistics Agency's Warstopper Program
Project No. D2006-D000LD-0096.000

Finding 1: Management of the Defense Logistics Agency's Warstopper Program

Recommendation 1: Identifies specific criteria to be used in the selection process, including a provision for medical commercial data and licenses to exploit the data

DLA's Comments: Concur. A revised Industrial Capability Program; Warstopper Program Management One Book Chapter provides the criteria in paragraphs 4.6.1.5.1.1 through 4.6.1.6.1.4

Disposition:

- (X) Action is Ongoing. ECD: Aug 30, 2007
() Action is considered complete

Recommendation 2: Standardizes the contents of the Program Description and Approval Document and establishes weighting factor for prioritizing similar investment included in the Program Description and Approval Document

DLA's Comments: Concur. A revised Industrial Capability Program; Warstopper Program Management One Book Chapter provides the standardized format and alternative evaluations in Section 5.

Disposition:

- (X) Action is Ongoing. ECD: Aug 30, 2007
() Action is considered complete

Recommendation 3: Defines the methodology for calculating the pre-return on investment in the Program Description and Approval Document.

DLA's Comments: Concur. A revised Industrial Capability Program; Warstopper Program Management One Book Chapter provides the methodology in Section 5.

Disposition:

- (X) Action is Ongoing. ECD: Aug 30, 2007
() Action is considered complete

Recommendation 4: Requires studies of lessons learned to help shortfalls in the Warstopper Program

DLA's Comments: Concur. A revised Industrial Capability Program; Warstopper Program Management One Book Chapter provides for lessons learned reports in paragraph 4.6.6.4.

Disposition:

- (X) Action is Ongoing. ECD: Aug 30, 2007
- () Action is considered complete

Team Members

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Inspector General Department *of* Defense

