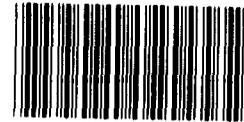




United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-248067



146258

March 31, 1992

The Honorable James H. Bilbray
House of Representatives

The Honorable Frank McCloskey
House of Representatives

In response to your request, we are providing information on ways to prevent inventory management problems such as excessive or defective parts. Our July 1991 report¹ stated our recommendations for addressing the principal problems. Since that time we have observed initial progress by the Department of Defense (DOD) in response to legislation that resulted from our report. This letter offers observations on areas where further DOD action is possible.

DOD has agreed with many of our past recommendations on inventory management improvements. However, DOD does not agree with us about the need to recognize and report excessive inventory as a step in minimizing excess and addressing other inventory management problems. As a result, we continue to find substantial weaknesses in DOD's inventory requirements determination process. Also, DOD has concurred with our recommendations for addressing defective items, but has not completed all corrective actions.

Although DOD has made some progress in improving its inventory management, congressional oversight is warranted, particularly with regard to the need for inventory that DOD reports as required.

EXCESSIVE INVENTORY REPORTED AS REQUIRED

We reported in July 1991 that changes in valuation methods were not fully disclosed, DOD did not report all its inventory in its Supply System Inventory Report, and inventory valued at billions of dollars was inappropriately

¹Defense Inventory: Reports Need Comparable and Comprehensive Data (GAO/NSIAD-91-266, July 17, 1991).

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reported as being required. In November 1991, DOD agreed with our recommendation on the need for consistent inventory valuation but objected to our recommendation that it report inventory in a manner that is consistent with how it defines the maximum assets that are to be on hand or on order at a given time.

DOD disagreed with our finding that \$10 billion of \$39.6 billion of Air Force and Navy inventory reported as being required in fact exceeded the amount that was to be on hand or on order. DOD stated that our finding was based on a definition to which it did not subscribe. According to DOD, it has consistently defined required inventory as inventory that is projected to be used through the end of a budget year and that it applies the same definition for both budgeting and reporting inventory. However, to identify the \$10 billion excessive inventory, we used DOD's definition (including war reserves) as stated in its instructions, not our own definition. Thus, we see no basis for DOD's statement that it does not subscribe to the definition. DOD stated it projects requirements to be used through the end of a budget year, however, our July 1991 report demonstrated that the inventory it reported as required would last beyond DOD's budget year. In addition, the definition DOD uses for budgeting is not the same as it uses for reporting inventory.

DOD cited three examples of inventory that it would have to exclude from its required inventory if our recommendations were adopted. We believe the examples show how DOD's policies for reporting can be used to obscure excessive inventory.

-- " . . . (1) any item needed the day after the inventory report . . ." DOD's ordering system is designed to provide a sufficient stream of supplies to meet needs on a continuing basis. The system provides for (1) on-hand supplies to meet needs for the immediate future and (2) due-in items, including those on-order, to ensure meeting needs beyond that. Adding more on-hand supplies to reports of required inventory than the amount that its instructions require can hide unnecessary and wasteful practices.

-- ". . . (2) valid current year inventory requirements for which the Congress has appropriated funds for procurement . . ." Having money available from overall Defense appropriations is not a sufficient basis to justify buying inventory that might not currently be needed.

-- ". . . (3) inventory the Department would need to include in its budget if it were not on hand." DOD's classifying items as being required, even though these items' use would not occur any time in the near future, if ever, sends the wrong message to item managers regarding effective and efficient management of their assigned inventories.

Our recent discussions with DOD representatives indicate that DOD actions may serve to obscure problems by changing the definition of what is required. Also, DOD is rewriting its inventory management regulations, apparently without giving adequate weight or incentives for curbing unrequired inventories. Both of these initiatives would aggravate existing problems.

DEFECTIVE MATERIALS

DOD Inspector General (DOD-IG) reports have criticized the quality of materials DOD accepts. For example, in September 1990, the DOD-IG reported² that 62 percent of the parts and products, such as fasteners, in a universe of 1.28 billion items worth about \$1 billion at the Defense Industrial Supply Center, did not conform to specifications and should have been rejected.

In a March 1991 report on management of stocks for which usability is unknown (suspended),³ we concluded that although the Defense Logistics Agency and the Navy had made improvements since a 1984 review, they still did not resolve the status of such stock in a timely manner. Secondary items, including possibly defective ones, had frequently remained suspended beyond DOD time standards because resolving their status was not a high priority, program guidance did not contain key elements, and the guidance was routinely not followed. We recommended that DOD ensure that

-- suspended items received adequate visibility at all management levels, up to and including the service level, and

²Nonconforming Products Procured by the Defense Industrial Supply Center (DOD-IG No. 90-113, Sept. 27, 1990).

³Defense Inventory: DLA and Navy Suspended Stocks Should Be Processed More Quickly (GAO/NSIAD-91-8, Mar. 14, 1991).

- responsibility and accountability were assigned for (1) resolving suspended stock status, (2) carrying out the actions, and (3) following up to make sure the actions are promptly and correctly taken.

DOD agreed with the two recommendations and notified the Congress that actions would be completed by September 30, 1991. However, as of March 18, 1992, DOD officials told us they were reconsidering the need to complete these corrective actions.

Our most recent evaluation that specifically addressed fasteners, an issue you had discussed in your request, was a requested review of the Air Force's decision to change military specifications for a class of fasteners. In September 1991, we reported⁴ that the Air Force had evidence indicating that deficiencies in specifications contributed to fatal accidents, other incidents that affected hardware performance, and acceptance of a substantial number of substandard fasteners in the DOD inventory. We concluded that the Air Force made the appropriate decision based on evidence it had available and other evidence that we examined.

One of the pieces of evidence was the inspection by the DODIG of the quality assurance program at the Defense Industrial Supply Center. When the Center discovered fastener fraud, it took several corrective actions, including

- adopting more rigorous specifications,
- incorporating a requirement for item traceability,
- instituting product verification testing, and
- pursuing legal actions.

⁴Military Fasteners: Changes to Specifications Are Justified (GAO/NSIAD-91-309, Sept. 30, 1991).

INCREASED OVERSIGHT WARRANTED

Although a clear need to resolve problems with on-hand defective and excessive inventory exists, we believe the solution deals with preventing unneeded and defective items from entering the inventory in the first place.

With regard to preventing excessive inventory, DOD's authorizing legislation for fiscal years 1992 and 1993 includes a restriction to keep inventory to no more than 2 years of operating stocks plus war reserves. Congressional debate and reports have recognized that the 2-year inventory is a maximum and that the amount on hand could often be much less than the maximum. Thus, we would expect DOD's implementation of the law to reduce the current quantity of required inventory on hand.

We believe that DOD's implementation of our recommendation to have the military report inventory in keeping with DOD's definition of the maximum assets that may be on hand or on order at a given time would be a good first step toward complying with the law. It would aim toward a consistent and realistic definition of required inventory. However, such planned changes as adding new categories of required inventory would seem to perpetuate, rather than solve, the DOD's inventory management problems. We believe DOD's position that it should continue to identify many years' worth of inventory as required demonstrates the mind-set that must be changed to solve its long-standing inventory management problems.

Congressional concern and oversight will be the key catalysts for the changes that need to be made in this area. There must be (1) recognition and acceptance of the problem by the decision makers, (2) knowledge of the involved costs, and, ultimately, (3) reduction of the amount of stocks held for longer term future use.

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Copies of each of the cited reports have been provided to your offices. If you have questions, please call me or Mr. Uldis Adamsons, Assistant Director, of my staff at (202) 275-4262.

Nancy R. Kingsbury
Nancy R. Kingsbury
Director
Air Force Issues

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