

GAO

Testimony



140973

For Release
Delivery
Expected at
9:30 a.m. EST
March 28, 1990

Continuing Problems in the Department of
Defense's Inventory Management

Statement of
Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division

Before the
Subcommittee on Readiness
Committee on Armed Services
House of Representatives



0-48112/140973

Mr. Chairman and Members of the Subcommittee;

I am pleased to be here today to discuss inventory management issues in the Department of Defense (DOD). Over the last 20 years, we have issued more than 100 reports dealing with specific aspects and problems in DOD's inventory management. In fact, we see the problems to be of such magnitude that we have identified defense inventory management as 1 of 14 government activities that are highly vulnerable to mismanagement, fraud, and abuse.

Today, I will discuss some of the long-standing problems in DOD's inventory management, some of the fundamental solutions to those problems, and the possibilities for making budget reductions. DOD has recently undertaken important initiatives aimed at correcting these problems. I have met with Deputy Secretary Atwood to discuss these initiatives and we have agreed to stay in contact as DOD's efforts progress. Effective implementation of the initiatives is what will make the difference and that will require continuing management leadership, commitment, and follow-through. DOD's track record in that regard is not good.

LONG-STANDING PROBLEMS IN DOD'S INVENTORY MANAGEMENT

This week we issued a report to the Secretary of Defense that summarizes our evaluations of DOD's inventory management. The problem areas we identified include growth in unrequired inventory, buying spare parts too early, not terminating contracts for excess on-order material, duplicative inventory due to multiple inventory levels, inaccurate records, inadequate controls over material and equipment furnished to government contractors, inadequate physical security, lax controls over shipments, deficiencies in supply cataloging, and computer system delays and cost overruns.

The sheer size of the supply system and its inventory complicates its management and increases its vulnerability to mismanagement, fraud, and abuse. The following are examples of the problems we and others have identified:

1. DOD's secondary inventory, such as spare and repair parts, grew by 138 percent in the 1980s, while unrequired inventory increased by 233 percent. As of September 30, 1988, about \$34 billion of DOD's secondary inventory was in unrequired stock, i.e., stock that is above requirements for current needs and reserves for future wars. In a report issued to you last week, we said that the Army's unrequired inventory grew by 168 percent between 1983 and 1988, compared to 96 percent for all DOD inventories. The largest growth, in terms of dollars, of

unrequired inventory occurred at the Aviation Systems Command, one of the six Army buying commands. Its unrequired inventory increased from \$207 million in 1983 to \$804 million in 1988. We found that the primary reasons the Command's unrequired inventory had increased were because (1) the Army has continued to stock items for systems being phased out, (2) demands forecasted for items often did not materialize, and (3) the database that computed requirements contained erroneous data. We also found the Army was not reducing or canceling planned procurements when the items were not needed. For example, a contract for 149 electronic actuators, costing \$259,376, was awarded in February 1988. The item manager had asked about canceling this procurement in November 1987, but no action was taken because procurement personnel said that the contract was already "out for bids."

We also reported this month that (1) the Air Force and Navy aircraft parts inventories grew from \$17.3 billion in 1980 to \$53.6 billion in 1988, and that unrequired aircraft parts increased at a faster rate than required parts and (2) the Navy's inventory of ship and submarine parts increased 249 percent between 1980 and 1988 to \$9.3 billion. In 1988, 40 percent, or \$3.7 billion, of the Navy's inventory of ship and submarine parts was unrequired.

2. All the services buy spare parts too early and in amounts that exceed current needs. For example, we recently reported that two Army buying commands had initiated item purchases earlier than they should have and also made purchases exceeding authorized requirements. In August 1989, we reported that 31 items with an estimated cost of \$87 million procured by the Army Tank-Automotive Command had been bought prematurely. Of these buys, about \$30 million, or more than 34 percent of the original purchase amount, was no longer needed to meet requirements that had been projected at the time the purchases were initiated. We found this practice is still occurring and in February 1990 issued a letter to the Army about this. In January 1988, we reported that of \$1 billion in procurement actions made by the Navy's Aviation Supply Office, \$133.7 million had been bought that was excess to its needs. We have also periodically pointed out where the Air Force was buying items too early.

3. The services often have millions of dollars of excess material on order. In November 1989, DOD's Office of the Inspector General issued a summary report of past DOD and GAO reports on excess on-order material for the Army, Navy, and Air Force. These reports identified excess assets totaling \$1.8 billion. We have also found cases where the Defense Logistics Agency (DLA) was not canceling purchases for unneeded material. As of

September 30, 1988, its supply centers reported \$471 million of excess material on order.

4. The services returned about 8.5 percent of the material they bought from DLA from 1981 to 1988. For fiscal years 1985 through 1989, we found that the services spent about \$1.7 billion of their operations and maintenance funds, excluding transportation costs, buying items they did not need from DLA which were later returned.

5. Excess stock is purchased to supply unnecessary multiple inventory levels. Item managers at one level often have not reported all of their excess items; consequently, managers at another level bought items unnecessarily. For example, in January 1990, we reported that 13 Army activities had \$184 million worth of spare and repair parts that were excess to their needs and had not been reported to the buying commands. At the same time, we found that three Army buying commands were buying 1,669 items worth \$66.9 million, which were the same items that were excess to needs. One retail level activity had an inoperable M-1 tank because it needed a tank turbine engine (unit price of \$316,912). The unit had requisitioned the item from a buying command. At the same time, there were 18 such turbine engines, valued at \$5.7 million, excess at other retail activities. However, because the buying command was not aware of the excess engines, it could not redistribute an engine to

the unit that needed it. DOD agreed that a single integrated supply system for the Army would improve the efficiency of item management, and when implemented, should reduce or prevent such problems.

6. Inventory records are inaccurate. For example, at two naval air stations, we recently found that 38 and 21 percent, respectively, of the inventory records we sampled had errors. One air station's records showed an on-hand quantity of 28 turbine seals costing \$760 each. We counted 20 seals, or 8 less than the records showed. The air station could not explain the difference.

7. Control over material and equipment furnished to government contractors is inadequate. As of September 1988, contractors reported to DOD they had \$56.5 billion of property. However, contractors' records do not, in many cases, adequately account for this property, and DOD and the services currently have no overall management or financial systems in place that could independently verify contractor records.

8. The physical security of DOD's inventory is lax. According to an October 1989 DOD physical security master plan, military installations have a high annual property loss rate. We have issued a number of reports dealing with lax physical security. For example, in January 1989, we reported that security

personnel at Clark Air Base did not take basic security precautions, such as controlling visitor entry and departure from the supply compound, properly installing security equipment, properly inspecting all packages carried through pedestrian gates, and repairing many large holes in the perimeter fence. We have ongoing work looking at the theft of weapon parts in New York and military equipment, such as F-16 engines, in Utah.

9. Controls over inventory in transit between locations are lax. In July 1988, we reported that supply depots did not accurately report receipts and that DOD could not confirm receipt for 87 of 453 shipments in our sample.
10. Supply items are listed in the supply catalog two or more times. As a result, excessive amounts of stocks are purchased. Besides duplicative stock, millions of dollars has been spent needlessly to enter and maintain the duplicate items in the catalog system.
11. Development of computerized systems to support logistics activities have experienced significant cost growth and development delays. For example, we reported in May 1989 that the Naval Aviation Logistics Command Information System had increased in estimated cost by \$89 million between 1987 and 1988. The system began development in 1977 and was to be

implemented in 1992. Program officials estimated that the system would be operational at 103 of 503 sites by 1999.

CORRECTING THE PROBLEMS

DOD has promised corrective actions in response to our recommendations in these areas, and it has made some improvements, such as amending policies and procedures to increase inventory accuracy by determining and correcting the cause of inventory inaccuracies. Such initiatives are encouraging, but substantial problems in DOD's inventory management remain because of inadequate follow-up to make sure corrective actions are implemented by the services and DLA.

A strong leadership commitment and a change in management philosophy are needed for corrective action. Another key element is a management agenda that places greater value on economy and efficiency than exists today. We believe the focus on filling orders and obligating funds interferes with the ability to function in a cost-effective manner. For example, in July 1986, the Army Materiel Command challenged the buying commands to obligate 75 percent of their fiscal year 1987 funds by March 31, 1987--halfway through the fiscal year. In March 1987, the Command directed the buying commands to initiate procurement before the reorder point whenever possible. According to Command officials, they provided this direction because DOD had reduced the Command's

budget because the Command had not spent the funds authorized for spares and repair parts in prior years.

We recently convened panels of experts in the logistics area from private industry, academia, and retired military flag officers and civilian government employees to comment on what they see as the main issues in DOD logistics. These panels reinforced our view of the need to change DOD's corporate culture and place more emphasis on economy and efficiency in DOD's inventory management. They also cautioned that DOD needs to consider the interrelationship of logistics functions and look at the total picture when making changes. They were particularly concerned about the need for timely, accurate, and responsive management information systems, and a well-trained and motivated logistics work force to deal with logistics issues in the 1990s. DOD needs to take advantage of private sector management innovation and technologies that have taken place over the last 10 years.

The recent Defense Management Report emphasis on streamlining is a step in the right direction. However, too often in the past good intentions have produced little change. With the Defense Management Report focusing on consolidation and reducing costs, care needs to be taken to ensure that the final result is a supply system that operates smoothly and efficiently, does not degrade readiness, and has substantially improved controls to prevent mismanagement, fraud, and abuse.

POTENTIAL BUDGET REDUCTIONS

Given that there is so much unrequired inventory, it is natural to ask where DOD's budget for inventory items can be cut. This is a particularly pertinent question in view of the recent events in the Soviet Union and Eastern Europe, the likely reduction in force levels, and the increasing warning time for a conventional war in Europe. The question of where to make cuts seems answerable-- they should be across the board. We have found inefficient and uneconomical practices and unrequired inventories at all the services and DLA.

The question of how much to cut is more difficult to answer. Nevertheless, unacceptable practices and excesses continue, despite past recommendations by us and others. Because of this and changing world conditions, there would seem to be little risk at this time were the Congress to reduce DOD's budget request for inventory to force it to amend its practices. Private industry found that the first step to reducing inventory was to establish inventory reduction goals. They worked, and inventories were reduced. Though not a direct correlation, one measure of how much DOD's budget might be reduced is the amount of excess items that are on order at any one time. The excess-on-order material for the Army and DLA represented about 10 percent of orders as of September 30, 1988. Such orders continue. Perhaps some reduction,

such as 10 percent, would encourage DOD to cost-effectively manage its inventory.

- - - - -

This concludes my prepared statement. I would be happy to answer any questions.