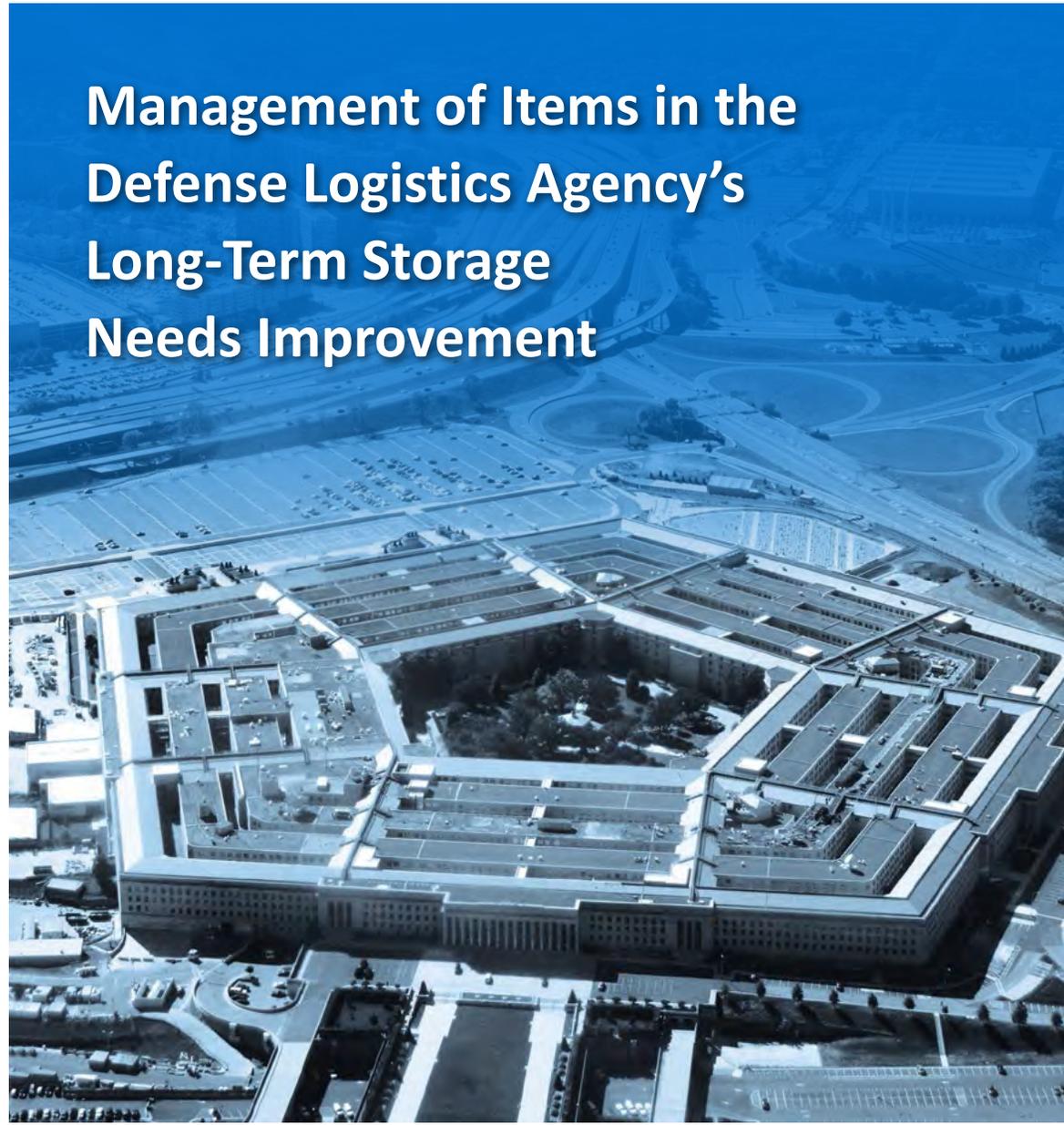




# INSPECTOR GENERAL

*U.S. Department of Defense*

DECEMBER 22, 2015



## Management of Items in the Defense Logistics Agency's Long-Term Storage Needs Improvement

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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# Results in Brief

## *Management of Items in the Defense Logistics Agency's Long-Term Storage Needs Improvement*

December 22, 2015

### Objective

We determined whether the Defense Logistics Agency (DLA) was effectively managing excess demilitarization (DEMIL) code B and sensitive DEMIL code Q items in Long-Term Storage (LTS). Specifically, we reviewed whether items assigned to LTS were justified and reused and whether unneeded items were disposed of promptly. DEMIL code B items are munitions list items that are defense-related property for military use, and sensitive DEMIL code Q items are commerce control list items.

### Findings

DLA did not effectively manage LTS inventory. Specifically, DLA stored items in LTS inventory that exceeded historical demand and, therefore, were not justified for retention. This occurred because although a policy memorandum directed DLA to review LTS items for continued retention after 24 months, the policy did not specify how to determine acceptable inventory levels for those items. As a result, DLA unnecessarily incurred costs to store 768,571 LTS inventory items, valued at \$169.5 million, that far exceeded the historical demand.

In addition, in 2014, DLA reused 216,003 LTS inventory items, valued at \$55.4 million, through its automated process to identify items for reuse (automated recoupment). However, DLA's process did not identify 87,135 LTS inventory items

### Findings (cont'd)

that could have been reused. This occurred because DLA inappropriately excluded 12 categories of LTS inventory from the automated recoupment process, and the process did not identify all LTS items eligible for recoupment. As a result, in 2014, DLA missed opportunities to offset or reduce purchases for items valued at \$17.9 million that were already in LTS inventory.

### Recommendations

We recommend that the Director, DLA:

- in coordination with the Assistant Secretary of Defense for Logistics and Materiel Readiness, implement a policy to establish a demand-based inventory management process for LTS inventory;
- determine acceptable inventory levels for LTS items based on the revised guidance and dispose of inventory items that exceed those inventory levels;
- update the automated recoupment process to eliminate excluded categories and ensure all items are appropriately recouped from LTS inventory; and
- determine why eligible LTS inventory items are not automatically recouped and correct those deficiencies in the automated recoupment process.

### Management Comments and Our Response

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA, addressed all specifics of the recommendations, and no further comments are required. Please see the Recommendations Table on the next page.

## ***Recommendations Table***

<b>Management</b>	<b>Recommendations Requiring Comment</b>	<b>No Additional Comments Required</b>
Director, Defense Logistics Agency	None	A.1, A.2, B.1, B.2



**INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
4800 MARK CENTER DRIVE  
ALEXANDRIA, VIRGINIA 22350-1500**

December 22, 2015

**MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE FOR LOGISTICS  
AND MATERIEL READINESS  
DIRECTOR, DEFENSE LOGISTICS AGENCY**

**SUBJECT: Management of Items in the Defense Logistics Agency's Long-Term Storage  
Needs Improvement (Report No. DODIG-2016-036)**

We are providing this report for your information and use. The Defense Logistics Agency stored items in long-term storage inventory that exceeded historical demand and therefore incurred costs to store \$169.5 million in excess inventory. In addition, the Defense Logistics Agency did not recoup all long-term storage inventory that could have been reused, resulting in \$17.9 million worth of unnecessary inventory purchases from contractors in 2014. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments on a draft of this report when preparing the final report. Comments from the Deputy Director, Defense Logistics Agency Logistics Operations, responding for the Director, Defense Logistics Agency, addressed all specifics of the recommendations and conformed to the requirements of DoD Instruction 7650.03; therefore, we do not require additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 699-7331 (DSN 499-7331).

A handwritten signature in black ink, reading "Carol N. Gorman".

Carol N. Gorman  
Assistant Inspector General  
Readiness and Cyber Operations

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## Acronyms and Abbreviations

# Introduction

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## Objective

Our audit objective was to determine whether the Defense Logistics Agency (DLA) was effectively managing excess demilitarization (DEMIL)<sup>1</sup> code B and sensitive DEMIL code Q items<sup>2</sup> in Long-Term Storage (LTS). Specifically, we reviewed whether items assigned to LTS were justified and reused, and whether unneeded items were disposed of promptly. See Appendix A for a discussion of the scope and methodology related to the objective.

## Background

On November 14, 2008, the Deputy Under Secretary of Defense for Logistics and Materiel Readiness issued a policy memorandum<sup>3</sup> that directed DLA to establish the LTS program. The LTS program was established to strengthen controls over, and minimize future security risks associated with the disposition of DEMIL code B and sensitive DEMIL code Q items. Because of those items' security risks and sensitivity, the memorandum required that DEMIL code B and code Q items be available for reuse only within DoD, the Foreign Military Sales programs, other Federal agencies, and designated special programs.

In January 2009, DLA opened an LTS facility in Columbus, Ohio, to receive, store, and process for reuse, excess DEMIL code B and sensitive DEMIL code Q items that had been turned in by DLA and the Military Services for disposition. In May 2012, DLA began to retain some DEMIL code B and code Q inventory at their distribution depots rather than transfer the items to the Columbus LTS facility because the facility was nearing capacity. Although stored at DLA distribution depots, the LTS inventory was owned by the LTS program and listed on the LTS inventory records.

On July 12, 2013, the Assistant Secretary of Defense for Logistics and Materiel Readiness (ASD[L&MR])<sup>4</sup> issued an updated LTS policy memorandum.<sup>5</sup> The memorandum directs DLA, in coordination with the Military Services, to continue

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<sup>1</sup> A DEMIL code is assigned to DoD personal property to indicate the degree of required physical destruction and to identify items that require specialized handling or procedures.

<sup>2</sup> DEMIL code B items are munitions list items that are defense-related property specifically designed, developed, configured, adapted, or modified for military use. DEMIL code Q items are commerce control list items designated as nonsensitive or sensitive based on control criteria established by the Department of Commerce.

<sup>3</sup> Deputy Under Secretary of Defense for Logistics and Materiel Readiness memorandum "Materiel Disposition Policy Change Concerning F-14 Parts, Demilitarization (DEMIL) Code B Munitions List Items (MLI), and Demilitarization Code Q Commerce Control List Items (CCLI)," November 14, 2008.

<sup>4</sup> In the National Defense Authorization Act for FY 2010, Congress changed the Deputy Under Secretary for Logistics and Materiel Readiness title to ASD(L&MR).

<sup>5</sup> ASD(L&MR) memorandum, "Materiel Disposition Policy Concerning F-14 Parts, Demilitarization (DEMIL) Code B Munitions List Items (MLI), and Demilitarization Code Q Commerce Control List Items (CCLI)," July 12, 2013.

to store and manage excess DEMIL code B and sensitive DEMIL code Q items in LTS. In addition, the memorandum directs DLA to review LTS inventory items after 24 months and mutilate and sell as scrap or dispose of items not needed.

As of November 2014, LTS inventory was stored at the Columbus LTS facility and the 17 DLA distribution depots located within the continental United States. The total LTS inventory consisted of 3.5 million inventory items (68,534 unique national item identification numbers<sup>6</sup> [NIIN]), valued at \$1.6 billion.

### ***Roles and Responsibilities***

The ASD(L&MR) serves as the principal staff assistant and advisor on logistics and materiel readiness matters to the Under Secretary of Defense for Acquisition, Technology, and Logistics; the Deputy Secretary of Defense; and the Secretary of Defense. The ASD(L&MR) issues policies and procedures for logistics, maintenance, materiel readiness, strategic mobility, and sustainment support in DoD that includes supply, maintenance, and transportation. ASD(L&MR) oversees Headquarters DLA at Fort Belvoir, Virginia.

Headquarters DLA:

- provides the Military Services, other federal agencies, and partner nation armed forces with a full spectrum of logistics, acquisition, and technical services;
- supplies nearly 90 percent of the military's spare parts;
- manages the reuse of military equipment;
- provides other services to the military and federal agencies; and
- oversees DLA Disposition Services (DS) at Battle Creek, Michigan.

DLA DS:

- is a subordinate organization to DLA;
- administers DoD's excess personal property<sup>7</sup> disposal program;
  - the program helps agencies dispose of unneeded excess property through reuse, transfer, donation, sale, or disposal;<sup>8</sup> and
- stores LTS inventory at the Columbus LTS facility and manages LTS inventory at that facility and at the distribution depots.

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<sup>6</sup> A NIIN is the last nine digits of an item's national stock number that uniquely identifies each supply item.

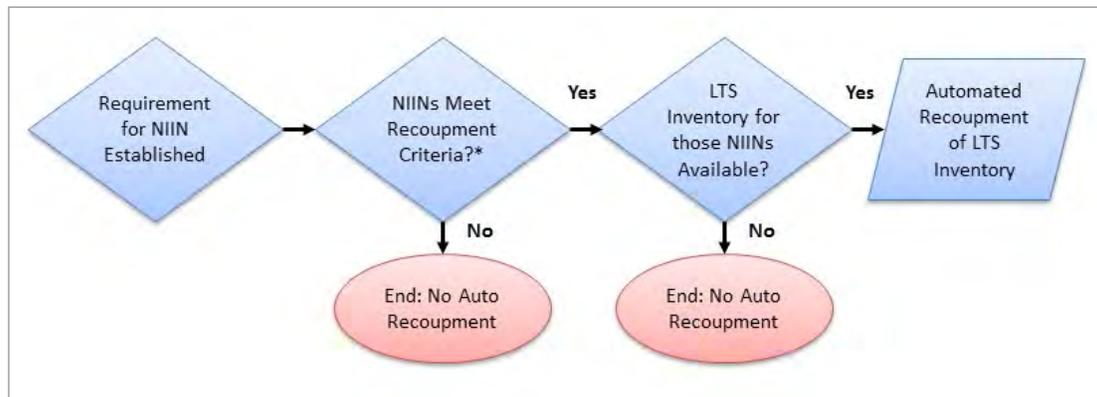
<sup>7</sup> All references to property in this report are personal property. DoD personal property is property other than real property and records of the Federal Government.

<sup>8</sup> DEMIL Code B and sensitive Q items cannot be sold, transferred, or donated to the public.

## DLA Automated Recoupment Process

DLA identifies LTS inventory items that can be reused through its “automated recoupment” process.<sup>9</sup> The automated recoupment process (Figure 1) runs nightly in DLA’s Enterprise Business System (EBS) to determine whether DLA requirements can be met with existing LTS inventory. Through this process, DLA can avoid new purchases, fill backorders, and maintain its levels of on-hand stock at the depots.

Figure 1. DLA Automated Recoupment Process for LTS Inventory



\* Material excluded from automated recoupment: Shelf Life, Flight Safety, Life Support, Customer-Direct Long-Term Contract, Obsolete, Local Purchase, Nonstocked, Semi-Active, Special Procedure, Hazardous, First-Article Test, and Exclusion items.

## Review of Internal Controls

DoD Instruction 5010.40<sup>10</sup> requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses with the management of the LTS inventory. Specifically, DLA stored items in LTS that exceeded historical demand and, therefore, were not justified for retention. Additionally, DLA’s automated recoupment process did not identify all LTS inventory that could have been recouped. We will provide a copy of this report to the senior official responsible for internal controls in DLA.

<sup>9</sup> DLA can also identify LTS items for reuse through a manual recoupment process. DoD, the Foreign Military Sales programs, other Federal agencies, and designated special programs can only obtain LTS inventory through the manual process.

<sup>10</sup> DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” May 30, 2013.

## Finding A

### Long-Term Storage Inventory Exceeded Historical Demand

DLA did not effectively manage LTS inventory. Specifically, DLA stored items in LTS inventory that exceeded historical demand and, therefore, were not justified for retention. This occurred because although the policy memorandum, dated July 12, 2013, directed DLA to review LTS items for continued retention after 24 months, the policy did not specify how to determine acceptable inventory levels for those items. Therefore, DLA retained all quantities of an LTS item if there was any demand for the item within the preceding 24 months, to include demand for as few as one item. As a result, DLA unnecessarily incurred costs to store 768,571 LTS inventory items (3,046 NIINs), valued at \$169.5 million, that far exceeded the historical demand.

### Stock Levels Exceeded Historical Demand

DLA stored quantities of DEMIL code B and sensitive DEMIL code Q NIINs in LTS inventory that far exceeded historical demand and, therefore, were not justified for retention. We compared the quantity of items in the November 2014 LTS inventory to the historical demand for those NIINs. To establish the historical demand, we identified LTS inventory that was reused during a 24-month period (2013 through 2014) and DLA purchases during a 12-month period (2014) for the same NIINs. We were conservative and used a multiplication factor of five times the historical demand to determine a “reasonable” inventory level for LTS items. In summary, we determined that 768,571 inventory items (3,046 NIINs), valued at \$169.5 million, were stored in excess of five times the historical demand for those NIINs.

DLA stored quantities of DEMIL code B and sensitive DEMIL code Q NIINs in LTS inventory that far exceeded historical demand and, therefore, were not justified for retention.

For example, a kit (NIIN 00-608-2271) used to repair the tracks of the M-88 series A2, HERCULES<sup>11</sup> had a demand of one item from 2013 through 2014. Using a demand multiplier of five, DLA would have established an inventory level of five items. However, there were 70,769 kits, valued at \$4.5 million, in LTS inventory as of November 2014, which far exceeded historical demand.

In another example, an electrical cable assembly (NIIN 00-255-8332) used for containerized maintenance facilities<sup>12</sup> had a demand of 33 items from 2013 through 2014. Using a demand multiplier of five, DLA would have established an inventory level of 165 items. However, there were 5,468 cable assemblies, valued at \$9 million, in LTS inventory as of November 2014, which far exceeded historical demand.

In another example, a shaft diaphragm (NIIN 00-460-5167) used on the KC-135 aircraft had a demand of one from 2013 through 2014. Using a demand multiplier of five, DLA would have established an inventory level of five items. However, there were 1,159 shaft diaphragms, valued at \$1.3 million, in LTS inventory as of November 2014, which far exceeded historical demand.

## Inventory Retained Regardless of Demand Quantity

DLA retained all quantities of an LTS item if there was any demand for the item within the preceding 24 months, to include demand for as few as one item. The ASD(L&MR) policy memorandum, dated July 12, 2013, directs DLA to review LTS items for continued retention after 24 months; however, the policy did not specify how to determine acceptable inventory levels for those items.

As a result of our audit, in April 2015, Office of the ASD(L&MR) and DLA personnel discussed revising the July 2013 policy memorandum to allow DLA more authority to store and manage LTS inventory levels based on historical demand. ASD(L&MR) stated that DLA had authority to implement policy to address the management of LTS inventory. However, as of September 2015, DLA had not issued a new LTS inventory management policy. The Director, DLA, in coordination with ASD(L&MR), should implement a policy to establish a demand-based inventory management process for LTS inventory. In addition, DLA should determine acceptable inventory levels for LTS items based on the revised policy and dispose of any inventory items that are in excess of those levels.

<sup>11</sup> HERCULES (Heavy Equipment Recovery Combat Utility Lift and Evacuation System) is a fully-tracked, heavy armored vehicle that can tow or lift heavy machinery from the battlefield weighing up to 70 tons.

<sup>12</sup> A containerized maintenance facility is stand-alone maintenance support package that may be tailored to meet mission needs.

## Unnecessary Storage Costs

By retaining unjustified amounts of LTS inventory, DLA unnecessarily incurred costs to store 768,571 LTS inventory items<sup>13</sup> (3,046 NIINs), valued at \$169.5 million. Although we used a demand multiplier of five, unnecessary storage costs<sup>14</sup> would be higher if DLA determines the demand multiplier for LTS inventory should be lower. For example, using a demand multiplier of two, DLA would have unnecessarily incurred costs to store 950,875 LTS inventory items (5,320 NIINs), valued at \$233.9 million. Regardless of the demand multiplier used, if DLA does not establish a demand multiplier, determine acceptable inventory levels based on that multiplier, and reduce its LTS inventory levels accordingly, DLA will continue to incur unnecessary LTS inventory storage costs.<sup>15</sup>

## Recommendations, Management Comments, and Our Response

### ***Recommendation A.1***

**We recommend the Director, Defense Logistics Agency, in coordination with the Assistant Secretary of Defense for Logistics and Materiel Readiness, implement a policy to establish a demand-based inventory management process for the long-term storage inventory.**

### *Defense Logistics Agency Comments*

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA agreed, stating DLA is working with the Office of the ASD (L&MR) to implement a policy allowing DLA to establish demand-based inventory management improvements to their long-term storage inventory. The estimated completion date is March 2016.

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<sup>13</sup> This represents 22 percent of the total inventory items.

<sup>14</sup> Storage costs consist of labor, inter-service support agreements, travel, shipping, and material handling equipment (rental and purchase) expenses.

<sup>15</sup> We cannot quantify the storage costs associated with the excess inventory since DLA does not allocate storage costs by NIIN or item.

## **Recommendation A.2**

**We recommend the Director, Defense Logistics Agency determine acceptable inventory levels for items in long-term storage based on the revised policy and dispose of inventory items that exceed those inventory levels.**

### *Defense Logistics Agency Comments*

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA, agreed, stating DLA drafted a supplemental policy directing DLA Disposition Services establish and maintain an appropriate retention level based on a two-year demand reutilization history. The estimated completion date is March 2016.

### *Our Response*

Comments from the Deputy Director addressed all specifics of the recommendations, and no further comments are required.

## Finding B

### DLA Could Have Recouped Additional LTS Inventory

In 2014, DLA identified 216,003 LTS inventory items (8,039 NIINs) for automated recoupment,<sup>16</sup> valued at \$55.4 million. However, DLA's automated recoupment process did not identify 87,135 LTS inventory items (2,962 NIINs) that could have been recouped. This occurred because:

- DLA inappropriately excluded certain categories of LTS inventory from the automated recoupment process; and
- DLA's automated recoupment process did not identify all LTS items eligible for recoupment.

As a result, in 2014, DLA missed opportunities to offset or reduce purchases for items valued at \$17.9 million that were already in LTS inventory.

### LTS Inventory Automatically Recouped

In 2014, DLA's automated recoupment process identified and recouped 216,003 items (8,039 NIINs) from LTS inventory, valued at \$55.4 million. The automated recoupment process determined that existing LTS inventory could meet DLA inventory requirements. For example, in 2014 DLA automatically recouped:

- 1,187 aircraft turbine rotor blades (NIIN 01-597-5143), valued at \$3 million, for the F110 jet engine. By using LTS inventory stored at the DLA Distribution Depot at Tinker Air Force Base, Oklahoma, DLA avoided purchasing new items from a contractor.
- 16 rotary actuators<sup>17</sup> (NIIN 01-276-8711), valued at \$500,000, for the KC-130 and F-16 aircraft. By using LTS inventory stored at the Columbus facility, DLA avoided purchasing new items from a contractor.

In 2014, DLA's automated recoupment process identified and recouped 216,003 items (8,039 NIINs) from LTS inventory, valued at \$55.4 million.

<sup>16</sup> DLA uses the term "recouped" when LTS items are brought back into DLA's regular inventory to avoid new purchases, fill backorders, and maintain DLA's stock on-hand inventory levels at the distribution depots. Once the items are back in depot inventory, they are available for purchase by customers.

<sup>17</sup> A rotary actuator is a motor that enables a part to rotate.

## LTS Inventory Not Identified for Recoupment

In 2014, DLA's automated recoupment process did not identify 87,135 items (2,962 NIINs) in LTS inventory that could have been recouped and, instead, DLA purchased new items from contractors. For example, in 2014 DLA purchased:

- 21 aircraft target canopies (NIIN 01-336-9615), valued at \$190,060, used for surface to air missile training. However, there were 55 canopies available for recoupment from LTS inventory at the DLA LTS facility in Columbus, Ohio. In addition to not recouping the canopies, DLA destroyed the canopies in LTS inventory 1 month after it purchased new ones.
- 208 buckle assemblies (NIIN 01-174-0175), valued at \$137,072, for the Apache helicopter. However, there were 442 buckle assemblies available for recoupment from LTS inventory at the DLA LTS facility in Columbus.
- 15 transmission input gears (NIIN 01-163-4573), valued at \$105,660, for the Apache helicopter. However, there were 64 gears available for recoupment from LTS inventory at the DLA LTS facility in Columbus, Ohio.
- 32 terminal boards (NIIN 01-284-1820), valued at \$104,035, for the Abrams M-1 tank. However, there were 974 terminal boards available for recoupment from LTS inventory at the DLA LTS facility in Columbus, Ohio, and at DLA Distribution Depots in Susquehanna, Pennsylvania and Warner Robins, Georgia.
- 50 hydraulic brake pistons (NIIN 01-411-7688), valued at \$76,565, for the B-2 aircraft. However, there were 102 hydraulic brake pistons available for recoupment from LTS inventory at the DLA Distribution Depot at Hill Air Force Base, Utah.

## Inventory Categories Inappropriately Excluded

DLA inappropriately excluded 51,589 items (1,953 NIINs) of LTS inventory from automated recoupment. Specifically, DLA programmed the automated recoupment process in EBS to exclude these categories from recoupment (See Appendix B for category definitions):

- items with a shelf life;
- flight safety material;
- life support material;
- items on customer-direct, long-term contract;
- obsolete items;
- local purchases;
- nonstock items;

- semi-active items;
- special-procedure items;
- hazardous material;
- items with an approved first-article test result; and
- exclusion items.

DLA excluded some categories<sup>18</sup> of LTS inventory from the automated recoupment process because DLA personnel were not confident with the items' condition. Specifically, DLA did not have a documented history for how the items were packaged and stored before being turned in to the LTS Columbus facility. In addition, DLA excluded other categories<sup>19</sup> of LTS inventory because they did not routinely store the items in the regular depot inventory. However, DLA inventory records indicated that the items were all condition code<sup>20</sup> A. Code A items are new, used, repaired, or reconditioned materiel that is serviceable and issuable to customers without limitation or restriction.

Because the condition code is a primary indicator whether an inventory item can be issued or reused, DLA should determine whether an LTS item can be automatically recouped based on the condition code and not exclude entire categories of inventory from recoupment. The Director, DLA, should update the automated recoupment process in EBS to include all categories of inventory to ensure all condition code A items are appropriately recouped from the LTS inventory.

## Process Did Not Identify all LTS Items Eligible for Automated Recoupment

DLA's automated recoupment process did not identify 35,546 eligible LTS items (1,009 NIINs) that could have been recouped. The automated recoupment process runs nightly in DLA's EBS to determine whether DLA requirements can be met with LTS inventory. However, we identified instances in which the process did not properly identify LTS inventory for recoupment that could have been used to meet DLA requirements. DLA personnel stated they were aware of the problem and in



DLA's automated recoupment process did not identify 35,546 eligible LTS items (1,009 NIINs) that could have been recouped.

<sup>18</sup> These categories were items with a shelf-life, flight safety material, life-support material, special procedure items, hazardous material, items with an approved first-article test result, and exclusion items.

<sup>19</sup> These categories were items on customer-direct long-term contract, obsolete items, local purchases, nonstock items, and semi-active items.

<sup>20</sup> Condition codes classify material in terms of readiness for issue and use.

December 2014, initiated a partial workaround so that additional LTS items could be identified for manual recoupment. However, DLA did not identify why the automated process was not working properly or implement a permanent solution that did not rely on manual intervention. The Director, DLA should determine why eligible LTS inventory items are not automatically recouped and correct those deficiencies in EBS.

## Unnecessary Purchases

DLA did not identify all LTS inventory eligible for recoupment and, as a result, it missed opportunities to offset or reduce \$17.9 million in purchases in 2014.

DLA did not identify all LTS inventory eligible for recoupment and, as a result, it missed opportunities to offset or reduce \$17.9 million in purchases in 2014. The LTS program's principle mission was to receive, store and offer reuse of serviceable equipment to authorized customers, therefore, allowing DLA to avoid purchasing new items, fill backorders, and maintain its levels of stock-on-hand at the depots. If DLA does not correct deficiencies with the automated recoupment process, it will continue to miss opportunities to reduce purchases and will continue to incur additional storage costs.

## Recommendations, Management Comments, and Our Response

### **Recommendation B.1**

**We recommend the Director, Defense Logistics Agency update the automated recoupment process in the Enterprise Business System to include all categories of inventory to ensure all condition code A items are appropriately recouped from the long-term storage inventory.**

### *Defense Logistics Agency Comments*

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA, agreed, but added that some inventory may not be appropriate for issue based on safety risk factors. The Deputy Director stated that DLA will review the business rules, and make system changes in the Enterprise Business System as needed, to ensure condition code A items are appropriate for recoupment from long-term storage inventory and distribution depot inventory. The estimated completion date is June 2016.

## ***Recommendation B.2***

**We recommend the Director, Defense Logistics Agency determine why eligible long-term storage inventory items are not automatically recouped and correct those deficiencies in the Enterprise Business System.**

### *Defense Logistics Agency Comments*

The Deputy Director, DLA Logistics Operations, responding for the Director, DLA agreed, stating DLA is reviewing the auto-recoupment business rules to correct any deficiencies in the Enterprise Business System. The Deputy Director stated that correcting the deficiencies will improve processes and identify inventory available to fill backorders and offset procurements. The estimated completion date is June 2016.

### *Our Response*

Comments from the Deputy Director addressed all specifics of the recommendations, and no further comments are required

## Appendix A

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### Scope and Methodology

We conducted this performance audit from December 2014 through November 2015 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 findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

### *Interviews and Documentation*

We interviewed ASD(L&MR) personnel responsible for LTS program guidance, DLA personnel responsible for LTS program management, and DLA Supply Chain Command supply planners and business process analysts.

We visited:

- DLA Headquarters, Fort Belvoir, Virginia;
- DLA Disposition Services, Battle Creek, Michigan;
- DLA Aviation, Richmond, Virginia;
- DLA Distribution Depot, Susquehanna, Pennsylvania;
- DLA Long-Term Storage Facility, Columbus, Ohio; and
- DLA Troop Support, Philadelphia, Pennsylvania.

We reviewed the following DoD and DLA policy and guidance to determine whether applicable guidance was followed for managing LTS inventory.

Specifically, we reviewed:

- DoD Manual 4160.28, Volume 2, "Defense Demilitarization: Demilitarization Coding," June 7, 2011;
- DoD Manual 4140.01, Volume 6, "DoD Supply Chain Materiel Management Procedures: Materiel Returns, Retention, and Disposition," February 10, 2014;
- DLA Instruction 3200.4, "Management of Aviation Critical Safety Items," January 25, 2006;
- Deputy Under Secretary of Defense for Logistics and Materiel Readiness memorandum "Materiel Disposition Policy Change Concerning F-14 Parts, Demilitarization (DEMIL) Code B Munitions List Items (MLI), and Demilitarization Code Q Commerce Control List Items (CCLI)," November 14, 2008, and

- ASD(L&MR) memorandum, “Materiel Disposition Policy Concerning F-14 Parts, Demilitarization (DEMIL) Code B Munitions List Items (MLI) and DEMIL Code Q Commerce Control List Items (CCLI),” July 12, 2013.

In addition, we reviewed purchase order data from DLA Office of Operations Research and Resource Analysis.

### ***Method to Determine Excess Inventory***

To determine whether DLA had excessive inventory levels for DEMIL code B and sensitive DEMIL code Q items, we compared DLA’s inventory levels at the LTS facility in Columbus, Ohio and the 17 Continental United States Distribution Depots, with the inventory quantities we determined were reasonable. To calculate reasonable inventory quantities for each item, we multiplied the item’s historical demand (previous 24 months, 2013 through 2014) recoupments plus the previous year (2014) purchase orders by a multiplication factor of five.

### ***Method to Determine Unnecessary Purchases of Items in LTS Inventory***

To determine whether DLA made unnecessary purchases of DEMIL code B and sensitive code Q items, we compared LTS inventory levels to DLA purchases in 2014 obtained from the DLA Office of Operations Research and Resource Analysis. For the NIINS in LTS inventory, we identified that DLA purchased 1.5 million items (2,962 NIINS), valued at \$73.8 million. We compared the date of the purchase order to the date the item entered the LTS inventory or, where applicable, the date the item was removed from LTS inventory. In addition, we compared purchases to historical recoupments (October 2012 through March 2015) to determine whether items had been recouped but not yet delivered at the time of the purchase.

To determine whether the automated recoupment process was working correctly, we nonstatistically sampled 24 of 1,567 NIINS from LTS inventory that were not automatically recouped even though the NIINS were not in the categories of LTS inventory that DLA inappropriately excluded. We selected the 24 NIINS that had the highest dollar value purchase orders and enough LTS inventory to cover the entire purchase order.

### **Use of Computer-Processed Data**

We used computer-processed data provided by DLA. We used DLA records from EBS to determine LTS inventory at the Columbus and 17 distribution depot locations as of November 25, 2014. We randomly sampled 78 NIINS located at the LTS facility in Columbus, Ohio to assess the accuracy of the LTS inventory data. We conducted a physical inventory of the 78 NIINS by comparing the quantity in the

inventory records to the item's physical existence in the warehouse. In addition, to assess the completeness of the Columbus facility inventory records, we conducted a reverse inventory of 45 NIINs by nonstatistically sampling items found near the first 45 NIINs in our 78 NIIN sample. We compared the NIIN quantity found in the LTS facility to the quantity in LTS inventory records. We found inaccuracies in both samples where the inventory quantities did not match the records. However, we did not find any errors that would question the data reliability that DLA stored items in LTS inventory in excess of historical needs.

We received spreadsheets of 2014 purchase orders from DLA Office of Operations Research and Resource Analysis personnel. To test the accuracy of the data, we reviewed procurement documentation contained within DLA's EBS and interviewed DLA supply planners. We did not identify any errors in the purchase order lists and determined that the data were sufficiently reliable to identify unnecessary purchases.

## **Use of Technical Assistance**

Personnel from the DoD OIG Quantitative Methods Division assisted us in selecting a random sample of NIINs in LTS inventory for data reliability testing.

## **Prior Coverage**

No prior coverage has been conducted on the LTS program during the last 5 years.

## Appendix B

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### Definitions of Items Excluded From Automated Recoupment

**Customer-Direct, Long-Term Contract.** A multi-year, multi-national stock number (sometimes a single national stock number contract), long-term agreement negotiated between an authorized acquisition specialists (preaward) and the supplier of best delivery and cost to the government to ship DLA owned material from the supplier location directly to a customer.

**Direct Purchase Item.** Item is acquired from the original equipment manufacturer, including a prime contractor who is an actual manufacturer of the item.

**Exclusion Items.** DLA manually blocks items from automated recoupment if a replacement item is planned that will make the blocked item obsolete, an item is located outside the continental United States, or the item is not designated condition code A.

**First-Article Test Item.** Contractually required testing and inspection of a supplier's pre-production, production, or production-representative specimens to evaluate whether the supplier can manufacture fully conforming products prior to the Government's commitment to receive subsequent production items. First-article testing is different from qualification testing.

**Flight Safety Material.** Any aircraft part, assembly, or installation containing a critical characteristic, such as dimension, tolerance, finish, material or assembly, manufacturing or inspection process, operation, field maintenance, or depot overhaul requirement that if nonconforming, missing, or degraded whose failure, malfunction, or absence may cause a catastrophic failure resulting in loss or serious damage to the aircraft or an unexpected engine shutdown resulting in an unsafe condition.

**Hazardous Material.** An item of supply that has a real or potential condition that can cause injury, illness, or death to personnel; damage to or loss of a system, equipment, or property; or damage to the environment.

**Life Support Material.** Aircraft installed equipment and components designed to protect, sustain, or save human lives. Life support items include, but are not limited to, ejection systems; crew seats; passenger seats; emergency escape slides; parachutes; life rafts and preservers; survival kits; emergency radios and beacons; aircrew helmets; oxygen masks; goggles; visors; chemical defense equipment; and selected clothing and uniform items.

**Local Purchase.** The direct purchase of an item by other than the organization assigned Coordinated Acquisition Program contracting responsibility or Integrated Material Management responsibilities such as the cataloging, requirements determination, procurement, distribution, overhaul, repair and disposal of materiel.

**Nonstocked Item.** Item is shipped directly from the vendor to the user (vendor stocked) or item is centrally managed but not stocked, and procurement will be initiated only after receipt of a request.

**Obsolete Item.** Item was replaced, is no longer procurable, or Service indicated that item is no longer needed. A replacement item national stock number is normally listed.

- Terminated item in stock, no future procurement is authorized, and requisitions may continue to be submitted until stocks are exhausted.
- Terminated item not in stock, no future procurement is authorized, and requisitions will not be processed.

**Semi-Active Item.** A potentially inactive item which must be retained in the supply system because stocks of the item are on-hand or in-use below the wholesale level.

**Shelf-Life Item.** An item of supply that has characteristics that decline or become unstable to the degree that a storage time period or condition(s) must be assigned to assure that it shall perform satisfactorily in service.

**Special Procedure Item.** Item is procured for a specific program with specific requirements such as special processes (part markings, fabrication and assembly), or special packaging and handling.

# Management Comments

## Defense Logistics Agency



**DEFENSE LOGISTICS AGENCY**  
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DEC 10 2015

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL  
(READINESS AND CYBER OPERATIONS)

SUBJECT: Response to DoDiG Draft Report "Management of Items in DLA Long-Term Storage Needs Improvement" (Project No. D2015-D000RD-0087.000)

Attached is the Defense Logistics Agency's (DLA) response to the subject Draft Report. We appreciate the opportunity to review and comment on the findings and recommendations. Management comments and recommendations are outlined on the attachment.

The point of contact for this audit is [REDACTED], DLA Office of the Inspector General, [REDACTED] or email: [REDACTED]

  
MICHAEL D. SCOTT  
Deputy Director  
DLA Logistics Operations

Attachment:  
As stated

## Defense Logistics Agency (cont'd)

### **Response to DOD IG Draft Report “Management of Items in DLA Long-Term Storage Needs Improvement” (Project No. D2015-D000RD-0087.000)**

As requested, Defense Logistics Agency (DLA) is providing the following response to Recommendations A.1, A.2, B.1 and B.2

**RECOMMENDATION A.1:** We recommend the Director, Defense Logistics Agency, in coordination with the Assistant Secretary of Defense (ASD) for Logistics and Materiel Readiness, implement a policy to establish a demand-based inventory management process for the long-term storage inventory.

**Response:** DLA concurs with the recommendation. DLA is working with the Office of the ASD (L&MR) to implement a policy that will allow DLA to establish demand-based inventory management improvements to our long-term storage inventory. Estimated completion date is March 2016.

**RECOMMENDATION A.2:** We recommend the Director, Defense Logistics Agency determine acceptable inventory levels for items in long-term storage based on the revised policy and dispose of inventory items that exceed those inventory levels.

**Response:** DLA concurs with the recommendation. DLA has drafted a supplemental policy which directs DLA Disposition Services to establish and maintain an appropriate retention level based on current two-year demand reutilization history. Estimated completion date is March 2016.

**RECOMMENDATION B.1:** We recommend the Director, Defense Logistics Agency update the automated recoupment process in the Enterprise Business System to include all categories of inventory to ensure all condition code A items are appropriately recouped from the long-term storage inventory.

**Response:** Response: DLA concurs with the intent of the recommendation. There are instances where DLA determines that not all items/categories located at long term storage sites are in Condition Code A hence, may not be appropriate for issue based on established safety risks factors. DLA will continue to review the current applicable business rules and make appropriate system changes in the Enterprise Business System as needed to include long-term storage DEMIL Code B&Q inventory and Distribution DEMIL Code B&Q inventory; and ensure that those Condition Code A items are appropriate for recoupment.

**RECOMMENDATION B.2:** We recommend the Director, Defense Logistics Agency determine why eligible long-term storage inventory items are not automatically recouped and correct those deficiencies in the Enterprise Business System.

**Response:** DLA concurs with the recommendation. DLA continues to review the auto-recoupment business rules to improve any deficiencies to the Enterprise Business System. This will improve processes for recoupments on items excluded from or not identified by the standard automated program such as when inventory is available to fill a backorder or offset procurement; the system will automatically identify this inventory. The review is on-going and should be completed by June 2016.

## Acronyms and Abbreviations

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<b>ASD(L&amp;MR)</b>	Assistant Secretary of Defense for Logistics and Materiel Readiness
<b>DEMIL</b>	Demilitarization
<b>DLA</b>	Defense Logistics Agency
<b>DS</b>	Disposition Services
<b>EBS</b>	Enterprise Business System
<b>LTS</b>	Long-term Storage
<b>NIIN</b>	National Item Identification Numbers

# **Whistleblower Protection**

## **U.S. DEPARTMENT OF DEFENSE**

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