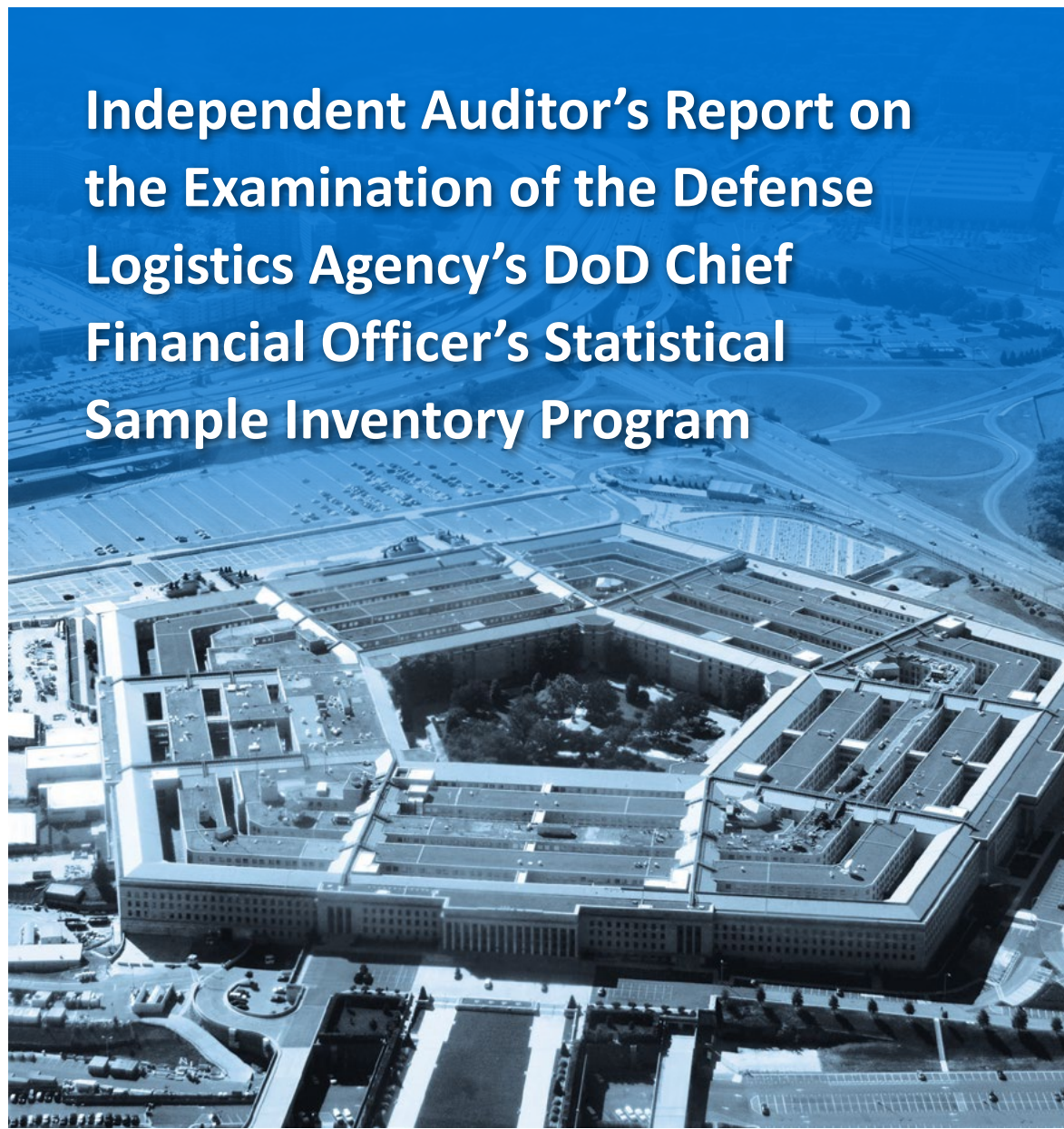




# INSPECTOR GENERAL

*U.S. Department of Defense*

AUGUST 25, 2017



## Independent Auditor's Report on the Examination of the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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

August 25, 2017

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF  
FINANCIAL OFFICER, DOD  
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT  
AND COMPTROLLER)  
DIRECTOR, DEFENSE LOGISTICS AGENCY  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE  
NAVAL INSPECTOR GENERAL  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Independent Auditor's Report on the Examination of the Defense Logistics Agency's  
DoD Chief Financial Officer's Statistical Sample Inventory Program  
(Report No. DODIG-2017-115, Project No. D2016-D000FI-0204.000)

We are providing this report for your information and use. In response to a Defense Logistics Agency request, we examined whether the sampling methodology used in the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program was adequately designed and the inventory results reported to the Military Services provided useful information to maintain accurate accountable property systems of record. We identified material weaknesses with the design and implementation of the sampling methodology and usefulness of the sample results provided to the Military Services.

We considered 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, 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) 601-5945.

A handwritten signature in blue ink that reads "Lorin T. Venable".

Lorin T. Venable, CPA  
Assistant Inspector General  
Financial Management and Reporting







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

August 25, 2017

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE (COMPTROLLER)/CHIEF  
FINANCIAL OFFICER, DOD  
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DIRECTOR, DEFENSE LOGISTICS AGENCY  
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE  
NAVAL INSPECTOR GENERAL  
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Independent Auditor's Report on the Examination of the Defense Logistics Agency's  
DoD Chief Financial Officer's Statistical Sample Inventory Program  
(Report No. DODIG-2017-115, Project No. D2016-D000FI-0204.000)

We examined whether the sampling methodology used in the Defense Logistics Agency's (DLA) DoD Chief Financial Officer's (CFO) Statistical Sample Inventory Program was adequately designed and the inventory results reported to the Military Services provided useful information to maintain accurate accountable property systems of record. The DLA is responsible for the development and execution of the DoD CFO Statistical Sample Inventory Program. The Defense Logistics Manual (DLM) 4000.25, volume 2, chapter 6, and DLM 4000.25-2, chapter 7, state that the purpose of the DoD CFO Statistical Sample Inventory Program is to enable the DLA and the Military Services to estimate the dollar value of the non-fuel inventory held in storage for their annual financial statement reporting.<sup>1,2</sup> DoD Components are required by the DLMs to conduct a statistical sample inventory for accurately estimating the dollar value of their respective on-hand supply inventories.<sup>3</sup>

<sup>1</sup> DLM 4000.25, volume 2, "Supply Standards and Procedures," chapter 6, "Physical Inventory Control," April 29, 2016.

<sup>2</sup> DLM 4000.25-2, "Military Standard Transaction Reporting and Accountability Procedures (MILSTRAP)," chapter 7, "Physical Inventory Control," April 29, 2016.

<sup>3</sup> The DoD CFO Statistical Sample Inventory Program covers the DLA and the Military Services. Our examination focused on the DLA's implementation of the program as it relates to the Military Services. We did not review how the DLA used the sampling methodology to estimate the dollar value of the non-fuel inventory held in storage on its financial statements.

The DLMs stated that the initial implementation of the program was for inventory and equipment in DLA storage sites managed by the Distribution Standard System (DSS) and the program may be expanded to include inventories beyond those maintained by DSS.<sup>4, 5, 6</sup>

The Deputy Director, DLA Logistics Operations, asserted that the physical inventory results reported to the Military Services of the FY 2016 CFO Statistical Sample Inventory Program were complete and accurate as of the date of the physical inventory execution. Specifically, the DLA asserted:

- the methodology used to develop the sample met the strata and confidence levels required; and
- the DLA depot, condition code, and quantity of each item reported in the CFO Inventory Results represented an asset that existed and the results were complete and accurate.<sup>7</sup>

In accordance with the engagement memorandum, we agreed to determine:<sup>8</sup>

- the adequacy of the sampling methodology detailed in DLA Standard Operating Procedure (SOP) 4000.02-04, “DoD CFO Statistical Sample Inventory Program,” February 2, 2016, by examining the population of items included in the physical inventory counts, samples of items selected by the DLA, and sample results provided by the DLA to the Military Services; and
- the usefulness of the sample results by holding discussions with the Military Services and reviewing what they did with the results of the physical inventories.

DLA management is responsible for its assertion. Our responsibility was to express an opinion on the adequacy of the sample methodology and usefulness of the sample results.

We conducted this examination in accordance with the attestation standards established by the American Institute of Certified Public Accountants and Generally Accepted Government Auditing Standards. These standards require that we plan and perform the examination to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our examination objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our examination objectives.

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<sup>4</sup> The DLMs use the term “materiel,” but for consistency in this report, we will use the terms “inventory and equipment.”

<sup>5</sup> There were 24 DLA Distribution Centers that stored inventory and equipment items as well as 3 Recruit Training Centers that stored uniform items for the Military Services. For consistency, we will refer to the DLA Distribution Centers and 3 Recruit Training Centers collectively as “storage sites” throughout this report.

<sup>6</sup> The DLA used DSS to manage most of the inventory and equipment stored in DLA storage sites. The DLA also uses systems other than DSS to manage DLA and Service-owned inventory and equipment in DLA storage sites. However, the DLA has not expanded the program to other systems.

<sup>7</sup> We began our examination after the DLA completed the physical inventories in August 2016. Therefore, we did not determine whether the DLA depot, condition code, and quantity of each item reported in the CFO Inventory Results represented an asset that existed and was complete and accurate. Accordingly, we will not express an opinion on that portion of the assertion.

<sup>8</sup> The Deputy Director, DLA Logistics Operations, did not sign the engagement memorandum, dated September 23, 2016.


In our opinion, the sampling methodology for DLA's DoD CFO Statistical Sample Inventory Program was not adequately designed and implemented. Although the inventory quantity adjustments reported to the Military Services were useful for updating the accountable property systems of record (property systems), the data provided to the Military Services to estimate the dollar value of Service-owned inventory and equipment items held at DLA storage sites were unreliable for financial statement reporting purposes. In addition to our adverse opinion on the assertion, we are including a finding on the design and implementation of the sampling methodology and the usefulness of the sample results for financial statement reporting purposes.

In accordance with government auditing standards, we are required to report:

- significant deficiencies and material weaknesses in internal control;
- instances of fraud and noncompliance with provisions of laws or regulations that have a material effect on the sampling methodology used in DLA's DoD CFO Statistical Sample Inventory Program and the usefulness of the sample results, or any other instances that warrant the attention of those charged with governance;
- noncompliance with provisions of contracts or grant agreements; and
- abuse that has a material effect on the subject matter.

We are also required to obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as any planned corrective actions.

We performed our examination to express an opinion on whether the sampling methodology for DLA's DoD CFO Statistical Sample Inventory Program was adequately designed and the inventory results reported to the Military Services provided useful information to maintain accurate accountable property systems of record. We did not perform the examination for the purpose of expressing an opinion on the internal controls or on compliance with laws and regulations and other matters; accordingly, we express no such opinions. Our examination disclosed a finding that is required to be reported under government auditing standards. The finding is enclosed, along with the views of responsible officials. Please see the Recommendations Table on the next page.



Lorin T. Venable, CPA  
Assistant Inspector General  
Financial Management and Reporting

Enclosure:  
as stated

## ***Recommendations Table***

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Director, Defense Logistics Agency	None	1, 2.a, 2.b, 2.c, 3	None

Note: The following categories are used to describe agency management's comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.



# Sampling Methodology Not Adequately Designed and Implemented

The DLA Office of Research and Resource Analysis (DORRA) personnel did not adequately design and implement the sampling methodology for DLA's DoD CFO Statistical Sample Inventory Program (the CFO Program).<sup>9</sup> Specifically, DORRA personnel did not:

- establish procedures to determine whether the population of assets in DLA storage sites used for the CFO Program was complete and accurate,<sup>10</sup>
- use valid statistical criteria when determining the sample sizes,
- use the same valuation methodology as the Military Services when assigning items in storage into the seven dollar value groupings and established one grouping of sample items that contained items without a standard unit price,<sup>11</sup> or
- select sample records and project the sample results consistent with the sample design.

This occurred because DORRA personnel lacked technical expertise of the complex statistical sampling techniques needed to implement the methodology. In addition, DORRA personnel did not effectively coordinate with appropriate personnel in the Military Services on the sampling methodology used to perform the physical inventory counts to ensure the results of the CFO Program were useful in preparing the Military Services' financial statements.

As a result, the data that the DLA provided to the Military Services to estimate the dollar value of inventory and equipment held at DLA storage sites were unreliable and not used for financial statement reporting purposes.

## DORRA Did Not Adequately Design Sampling Methodology

DORRA personnel did not adequately design the sampling methodology for the CFO Program. Unlike the other types of physical inventory counts conducted by the DLA that are designed for measuring accuracy, quantity, and performance, the DLA designed the CFO Program to estimate the dollar value of the non-fuel inventory held at DLA storage sites.<sup>12</sup> The Financial Audit Manual, volume 1, states that a sample should be drawn from

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<sup>9</sup> The CFO Program covered both Service-owned and DLA assets. The purpose of the CFO Program was to enable the DLA and the Military Services to estimate the dollar value of the non-fuel inventory held in storage for their annual financial statement reporting.

<sup>10</sup> The population includes both Working Capital Fund and General Fund assets. Most of the assets belong to the Working Capital Fund and are classified as inventory items. The assets that belong to the General Fund are classified as equipment. For financial reporting purposes, inventory and equipment are reported on different lines on the balance sheet.

<sup>11</sup> DSS did not contain a standard unit price for these items. Consequently, a standard unit price of zero was assigned to them. 26,448 of the 2,302,045 records in the DSS population used for the FY 2016 CFO Program did not contain a standard unit price.

<sup>12</sup> DLM 4000.25, volume 2, chapter 6, and DLM 4000.25-2, chapter 7, describes the different types of physical inventory counts and their purpose.

a population that represents the whole set of items on which a conclusion will be reached.<sup>13</sup> DLA SOP 4000.02-04 documented the sampling requirements and detailed procedures for performing the annual CFO Program.<sup>14</sup> This included the use of strata, or groupings of items, and confidence levels that were consistent with requirements in DLM 4000.25, volume 2, chapter 6, and DLM 4000.25-2, chapter 7.<sup>15</sup> However, DLA personnel did not establish procedures to determine whether the population of assets in DLA storage sites used for the CFO Program was complete and accurate, use valid statistical criteria, or use the same valuation methodology as the Military Services when assigning items to the seven-dollar value groupings.<sup>16</sup>

### ***DLA Did Not Use a Reconciled Population of Items to Perform Sampling***

DORRA personnel did not establish procedures to determine whether the population of assets in DLA storage sites used for the CFO Program was complete and accurate. DoD Manual 4140.01, volume 5, requires that the inventory control points and storage activities collaborate to ensure that the inventory data in their respective systems are the same.<sup>17,18</sup> In addition, DLM 4000.25, volume 2, chapter 6, and DLM 4000.25-2, chapter 7, require that owners, managers, and storage activities conduct annual reconciliations of all records. GAO-14-704G, “Standards for Internal Control in the Federal Government,” and the April 2016 DoD Financial Improvement and Audit Readiness Guidance state that a reconciliation of data between systems is a key transaction control activity to support an entity in achieving its objectives and addressing related risks. Reconciling property systems will help DoD agencies better manage their inventory and move closer to achieving auditable financial statements. However, the DLA and the Military Services used different property systems to manage their inventory and equipment at DLA storage sites and did not routinely reconcile the ending balances of inventory and equipment in their respective systems. For example, Army personnel stated they have not fully determined how they will reconcile on-hand quantity balances between Army Working Capital Fund and DSS until the DLA can

<sup>13</sup> GAO-08-585G, Financial Audit Manual, volume 1, July 2008, issued by the Government Accountability Office and President’s Council on Integrity and Efficiency, presents a methodology to perform financial statement audits of federal entities in accordance with professional standards established by the American Institute of Certified Public Accountants and Government Auditing Standards, as well as Office of Management and Budget guidance.

<sup>14</sup> The CFO Program replaced the Military Service’s individual sampling plans in August 2011 in an effort to standardize inventory sampling plans and streamline efforts. DLA SOP 4000.02-04 required the Director of DORRA to develop the CFO Program to ensure that populations and units of analysis for DLA and the Military Services were consistent with standard accounting practices. After the DLA conducted physical inventory counts, DORRA was to provide a spreadsheet workbook to DLA and the Military Services of the net inventory dollar misstatements and error bounds resulting from the physical inventory counts.

<sup>15</sup> The confidence level is a measure of the reliability of a result.

<sup>16</sup> DLA SOP 4000.02-04 listed seven dollar value groupings: four groupings were for extended dollar values (quantity multiplied by standard unit price) from \$.01 to less than \$10 million, one grouping was for extended dollar values more than \$10 million and a unit cost less than \$1 million, one grouping was for all items with a unit cost greater than \$1 million, and the last grouping was for items with a standard unit price of zero dollars.

<sup>17</sup> DoD Manual 4140.01, volume 5, “DoD Supply Chain Materiel Management Procedures: Delivery of Materiel,” February 10, 2014.

<sup>18</sup> DoD Manual 4140.26-M-1, volume 1, “DoD Integrated Materiel Management for Consumable Items: Operating Procedures for Item Management Coding,” September 24, 2010, defines an inventory control point as an inventory organizational unit or activity within the DoD supply system that is assigned the primary responsibility for the materiel management of a group of items either for a particular Military Department or for the Department of Defense as a whole.

help Army differentiate between General Fund and Working Capital Fund inventory and equipment in DSS. Consequently, DORRA personnel did not base the sampling on a population of Service-owned inventory and equipment that had been reconciled with Military Services' property systems. Rather, DORRA personnel used weekly database update files from DSS to compile the inventory and equipment population for each Military Service and reviewed the population to ensure that the record counts within DSS remained consistent from week to week. By not comparing DSS to the Military Services' property systems, DORRA personnel did not ensure they had a complete and accurate population from which to sample the assets at DLA storage sites.

### ***DLA Used Flawed Statistical Criteria to Determine Sample Sizes***

DLA personnel did not use valid statistical criteria when determining the sample sizes for the FY 2016 CFO Program. DLA SOP 4000.02-04 identified sample sizes for each of the nine funding types.<sup>19</sup> However, DORRA personnel stated that the sample sizes in DLA SOP 4000.02-04 were actually target values chosen based on the number of items that staff at the storage sites could inventory in a 1 month period. DORRA personnel stated that they selected sample items based on National Item Identification Number and DLA storage site.<sup>20</sup> Therefore, instead of calculating sample sizes based on the statistical design, DORRA and DLA Logistics Operations personnel created the sample sizes based on the historical workload capability of DLA personnel available at the storage sites to perform the physical inventory counts during August 2016.<sup>21</sup> Constraining the number of items requiring physical inventory counts, without following valid statistical criteria, was inappropriate.

### ***DLA Used a Different Valuation Methodology Than Military Services***

DORRA personnel used a different valuation methodology than the Military Services when assigning items in storage to the dollar value groupings. DORRA personnel grouped the items in storage by dollar value. The April 2016 DoD Financial Improvement and Audit Readiness Guidance states that one of the audit readiness "dealbreakers" for the Balance Sheet is the inability to produce a population of transaction details which reconcile to each financial statement line item.<sup>22</sup> Consequently, the method used by the DLA and the Military Services to value Service-owned inventory and equipment held by the DLA should be the same. However, DORRA's use of standard unit price to value non-DLA items was inconsistent with the valuation methodology used by the Military Services to value their inventory and

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<sup>19</sup> The nine funding types consisted of the DLA Working Capital Fund and a Working Capital Fund and a General Fund for each of the four Military Services (Army, Navy, Air Force, Marine Corps).

<sup>20</sup> The National Item Identification Number is the last nine digits of the National Stock Number that differentiates each individual supply item from all other supply items.

<sup>21</sup> DLA Logistics Operations is responsible for the end-to-end supply chain management of DLA's nine supply chains, providing logistics and materiel process management policy, guidance, and oversight while conducting continuous assessments of supply chain performance.

<sup>22</sup> The April 2016 DoD Financial Improvement and Audit Readiness Guidance defines dealbreakers as items that have prevented reporting entities from demonstrating audit readiness or succeeding in audits.

equipment.<sup>23</sup> DORRA personnel used the standard unit price multiplied by item quantity to create the groups of items for sampling. This included one grouping of items without a standard unit price. DORRA personnel assigned standard unit prices to the Service-owned items using the same inventory valuation method that the DLA used. However, the Military Services did not value their inventory and equipment at standard unit prices. Instead, the Military Services valued their inventory and equipment using various other valuation methodologies, including Moving Average Cost, Latest Acquisition Cost, and Net Realizable Value.<sup>24</sup> The use of different valuation methodologies could result in differences in the grouping in which items were placed.

## **DORRA Did Not Adequately Implement Sampling Methodology**

DORRA personnel did not adequately implement the sampling methodology for the CFO Program. Specifically, DORRA personnel used a different methodology to select items for sampling than the methodology used to project the results of the physical inventory counts. DLA SOP 4000.02-04 required DORRA personnel to use a sampling methodology called the Probability Proportional to Size (PPS) when designing the sampling.<sup>25</sup> After DORRA personnel created the groupings of items for sampling, they used the simple random sample method to select the items to inventory from the groupings.<sup>26</sup> DORRA personnel then used the PPS methodology to project the results. The use of a sample selection method that did not comply with the DLA SOP and was inconsistent with the sample design did not produce reliable results for the Military Services to use for estimating the dollar value of the on-hand inventories at DLA storage sites. To achieve reliable results, the sampling methodology should be implemented as designed.

## **DLA Lacked Technical Expertise and Did Not Effectively Coordinate with Military Service Financial Managers to Ensure Use of Appropriate Statistical Sampling Techniques**

DORRA personnel lacked technical expertise of the complex statistical sampling techniques needed to implement the methodology. DLA previously used the sampling methodology to estimate only DLA inventory values. When DLA expanded the sampling methodology to the Military Services, DORRA senior operations research analysts worked with an Air Force statistician to develop the sampling methodology. However, the design and implementation of these complex statistical sampling techniques was beyond DLA's technical expertise as

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<sup>23</sup> Standard unit price is the price established annually for each item during the budget process. The DLA maintains a standard unit price for inventory items in DSS.

<sup>24</sup> These valuation methodologies are defined in DoD 7000.14-R, "Financial Management Regulation," volume 4, chapter 4, "Inventory and Related Property."

<sup>25</sup> PPS sampling includes a number of sample selection methods in which the probability of selection for a sampling unit is directly proportional to a size measure, in this case total price.

<sup>26</sup> A simple random sample is a subset of a statistical population in which each member of the subset has an equal probability of being chosen.

evidenced by the problems we identified in this report. In addition, although DLA invited the Military Services to observe the physical inventories being performed, DLA personnel did not effectively coordinate with the appropriate financial management personnel within the Military Services on the sampling methodology used to perform the physical inventory counts. DLA had not involved personnel who were adequately familiar with financial statement requirements when designing the sampling plan. The financial community needs to have a more active role in the sample design and execution to ensure the sampling methodology meets financial audit readiness needs. To provide the Military Services with more useful sample results of their items in DLA's custody that can be used by Independent Public Accounting firms performing audits of the Military Services' financial statements, the sampling methodology may need to be improved to require that the Military Services provide DLA with the items to be sampled. The Director, DLA, should require that DORRA personnel consult personnel with an appropriate technical understanding of the complex statistical sampling techniques used and collaborate with Military Service financial managers responsible for audit readiness activities to determine the best sampling methodology for determining the financial accuracy of Service-owned items in DLA custody.

To measure accuracy of the dollar value of inventory and equipment stored at DLA storage sites as of the end of the fiscal year, the CFO Program must be properly designed. Deficiencies in the CFO Program design limited its usefulness. DLA should update DLA SOP 4000.02-04 to:

- a. establish procedures to determine whether the population of assets in DLA storage sites used for the CFO Program was complete and accurate by requiring evidence of properly completed reconciliations between the Military Services' accountable property systems of record and DSS;
- b. use valid statistical criteria when determining the sample sizes; and
- c. use the same valuation methodology as the Military Services when assigning items in storage into dollar value groupings, including items without a standard unit price.

Achieving reliable results requires that the sample projection method be consistent with the sample design and the use of the most appropriate sampling methodology. DLA should require that DORRA personnel use the sampling methodology to design the sampling, select sample records, and project the results of the physical inventory counts consistent with the sample design.

## DLA Sent Unreliable Sample Results to Military Services

The DLA provided unreliable data to the Military Services to estimate the dollar value of inventory and equipment held at DLA storage sites and the information was not used to estimate the dollar value of Service-owned items held at DLA storage sites for financial statement reporting purposes. Although the inventory quantity adjustments reported by DLA to the Military Services throughout the inventory were useful for updating the Military Services' property systems, none of the Military Services used the data to estimate the dollar value of their inventory and equipment held at DLA storage sites. The DLA reported that it initiated 25,331 adjustments to the Military Services property systems based on the physical inventory counts performed in August 2016 at DLA storage sites using DSS. As DLA personnel performed the physical inventory counts, they updated DSS with any quantity adjustments needed. The quantity adjustments were then sent through the Defense Automatic Addressing System to the interfacing property systems to update the Military Service balances as needed.

In September 2016, the DLA provided the Military Services with the methodology and results of the August 2016 physical inventory counts which required the Military Services to enter the item quantities and acquisition cost into the files DORRA personnel provided. The physical inventory results were difficult to use because the Military Services were required to manually enter the acquisition costs for all their inventory and equipment into the files the DLA provided before the files could be used to compute an estimated dollar value of inventory and equipment held at DLA storage sites. The Military Services are documenting and supporting their valuation methodologies for inventory and equipment in accordance with recently issued generally accepted accounting principles.<sup>27</sup>

The problems with the design and implementation of the sampling methodology prevented the sample results from being statistically sound and reliable for estimating the dollar value of inventory and equipment held at DLA storage sites on the Military Services' financial statements. In order for the DLA to provide useful information to the Military Services and the Independent Public Accounting firms performing financial statement audits starting in FY 2018, the DLA needs to improve the sampling methodology so the results can be relied upon and help prevent financial statement auditors from duplicating work efforts.

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<sup>27</sup> Statement of Federal Financial Accounting Standards No. 48, "Opening Balances for Inventory, Operating Materials and Supplies, and Stockpile Materials," January 27, 2016; and Statement of Federal Financial Accounting Standards No. 50, "Establishing Opening Balances for General Property, Plant, and Equipment," August 4, 2016.



## Recommendations, Management Comments, and Our Response

### ***Recommendation 1***

**We recommend the Director, Defense Logistics Agency, require that Defense Logistics Agency Office of Research and Resource Analysis personnel consult personnel with an appropriate technical understanding of complex statistical sampling techniques and collaborate with Military Service financial managers responsible for audit readiness activities on the sampling methodology for determining the financial accuracy of Service-owned items in Defense Logistics Agency's custody as part of the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program. We further recommend that the Director, Defense Logistics Agency, determine whether the continued use of Probability Proportional to Size sampling methodology is appropriate for the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program.**

### *Defense Logistics Agency Comments*

The Deputy Director, Defense Logistics Agency Logistics Operations, responding for the Director, Defense Logistics Agency, agreed with the recommendation, stating that the Executive Director, Logistics Policy and Strategic Programs, and DORRA agree additional consulting and collaboration with other technical personnel would improve the current process. The Deputy Director stated that collaboration will continue between the DLA and the Military Services' financial managers on sampling methodologies to enable continual process improvement. He also stated that the DLA will incorporate discussions about the sampling methodology into the upcoming coordination meetings between the DLA and the Military Services on support to the Military Services' financial statement audits. The Deputy Director stated the estimated completion date for these actions is July 31, 2018.

### *Our Response*

Comments from the Deputy Director addressed all specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation after the DLA provides documentation showing that DORRA has consulted appropriate technical experts, collaborated with Military Service financial managers responsible for audit readiness on the sampling methodology to be used going forward, and determined whether the continued use of Probability Proportional to Size sampling methodology is appropriate for the DLA's DoD Chief Financial Officer's Statistical Sample Inventory Program.

## ***Recommendation 2***

**We recommend the Director, Defense Logistics Agency, update Defense Logistics Agency Standard Operating Procedure 4000.02-04 to:**

- a. Establish procedures to determine whether the population of assets in Defense Logistics Agency storage sites used for the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program was complete and accurate by requiring evidence of properly completed reconciliations between the Military Services' accountable property systems of record and the Distribution Standard System.**

### ***Defense Logistics Agency Comments***

The Deputy Director, Defense Logistics Agency Logistics Operations, responding for the Director, Defense Logistics Agency, agreed with the recommendation, stating that the Executive Director, Logistics Policy and Strategic Programs, and DORRA will coordinate to review and update DLA SOP 4000.02-04 to incorporate obtaining evidence from the Military Services of completed reconciliations between appropriate Military Service systems and DSS. The Deputy Director stated that the DLA will incorporate discussions about reconciliations with DSS into the upcoming coordination meetings between the DLA and the Military Services on support to the Military Services' financial statement audits. The Deputy Director stated the estimated completion date for these actions is July 31, 2018.

### ***Our Response***

Comments from the Deputy Director addressed all specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation after the DLA provides documentation showing that DLA SOP 4000.02-04 has been updated to require evidence of completed reconciliations between the Military Services' accountable property systems of record and DSS.

- b. Use valid statistical criteria when determining the sample sizes.**

### ***Defense Logistics Agency Comments***

The Deputy Director, Defense Logistics Agency Logistics Operations, responding for the Director, Defense Logistics Agency, agreed with the recommendation, stating that the Executive Director, Logistics Policy and Strategic Programs, and DORRA will coordinate to review and update DLA SOP 4000.02-04 to incorporate use of a statistically valid criteria when determining sample sizes. The Deputy Director also stated that the DLA will incorporate discussions about the statistically valid criteria for determining sample sizes into the upcoming coordination meetings between the DLA and the Military Services on support to the Military Services' financial statement audits. The Deputy Director stated the estimated completion date for these actions is July 31, 2018.

### *Our Response*

Comments from the Deputy Director addressed all specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation after the DLA provides documentation showing that DLA SOP 4000.02-04 has been updated to incorporate use of statistically valid criteria when determining sample sizes.

- c. Use the same valuation methodology as the Military Services when assigning items in storage into dollar value groupings, including zero-valued items.**

### *Defense Logistics Agency Comments*

The Deputy Director, Defense Logistics Agency Logistics Operations, responding for the Director, Defense Logistics Agency, agreed with the recommendation, stating that the Executive Director, Logistics Policy and Strategic Programs, and DORRA agree that the sampling methodology should incorporate the valuation used by the Military Services. However, the Deputy Director stated that since the DLA does not have access to the valuation used by the Military Services, both organizations will coordinate with the Military Services to determine whether the DLA or the Military Service is the best source to generate the samples for the annual CFO statistical sample inventory. He also stated that appropriate updates will be made to DLA SOP 4000.02-04 based upon the outcome of the discussions. In addition, the Deputy Director stated that the DLA will incorporate discussions about reconciliations with DSS and the best source for the sample into the upcoming coordination meetings between DLA and the Military Services on support to the Military Services' financial statement audits. The Deputy Director stated the estimated completion date for these actions is July 31, 2018.

### *Our Response*

Comments from the Deputy Director addressed all specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation after the DLA provides documentation showing that DLA SOP 4000.02-04 has been updated to incorporate the valuation methodology used by the Military Services and reflect the impact of decisions regarding whether the DLA or the Military Services is the best source to generate the samples for the DLA's DoD Chief Financial Officer's Statistical Sample Inventory Program.

### ***Recommendation 3***

**We recommend the Director, Defense Logistics Agency, require that Defense Logistics Agency Office of Research and Resource Analysis personnel use the sampling methodology to design the sampling, select sample records, and project the results of the physical inventory counts consistent with the sample design.**

#### ***Defense Logistics Agency Comments***

The Deputy Director, Defense Logistics Agency Logistics Operations, responding for the Director, Defense Logistics Agency, agreed with the recommendation, stating that the Executive Director, Logistics Policy and Strategic Programs, and DORRA will coordinate to update the sampling methodology and design to ensure the end-to-end process is consistent. The Deputy Director stated that the DLA will conduct a comprehensive review incorporating the input from the Military Services and update the sample methodology and design accordingly. The Deputy Director stated the estimated completion date for these actions is July 31, 2018.

#### ***Our Response***

Comments from the Deputy Director addressed all specifics of the recommendation. Therefore, the recommendation is resolved but will remain open. We will close this recommendation after the DLA provides documentation showing that the sample methodology is being used to design the sampling, select sample records, and project the results of the physical inventory counts consistent with the sample design.

# Management Comments

## Defense Logistics Agency Comments



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

**JUL 24 2017**

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Response to DODIG Draft Report, "Examination of the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program" (Project #D2016-DOOOFI-0204.000)

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]

A handwritten signature in black ink, appearing to read "M. Scott", is positioned above the printed name of Michael D. Scott.

MICHAEL D. SCOTT  
Deputy Director  
DLA Logistics Operations

Attachment:  
As stated

## Defense Logistics Agency Comments (cont'd)

### DLAJ3

**Response to Recommendations contained in the July 11, 2017 Draft Report:  
DoD IG Draft Report, "Examination of the Defense Logistics Agency's DoD Chief Financial  
Officer's Statistical Sample Inventory Program  
(Project# D2016-DOOOFI-0204.000)**

**Recommendation 1:** Director, Defense Logistics Agency, require that Defense Logistics Agency Office of Research and Resource Analysis personnel consult personnel with an appropriate technical understanding of complex statistical sampling techniques and collaborate with Military Service financial managers responsible for audit readiness activities on the sampling methodology for determining the financial accuracy of Service-owned items in Defense Logistics Agency's custody as part of the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program. We further recommend that the Director, Defense Logistics Agency, determine whether the continued use of Probability of Proportion to Size sampling methodology is appropriate for the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program.

**DLA Response to Recommendation 1:** Concur. The Executive Director, Logistics Policy and Strategic Programs and DORRA agree additional consulting and collaboration with other technical personnel would improve the current process. Collaboration will continue between DLA and Military Service financial managers on sampling methodologies - to enable continual process improvement.

**Specific actions taken or expected to be taken:** DLA will incorporate discussions about the sampling methodology into the upcoming coordination meetings between DLA and the Military Services on support to the Military Services' financial statement audits.

**Estimated Completion Date:** July 31, 2018

**Recommendation 2:** We recommend the Director, Defense Logistics Agency, update Defense Logistics Agency Standard Operating Procedure 4000.02-04 to:

- establish procedures to determine whether the population of assets in Defense Logistics Agency storage sites used for the Defense Logistics Agency's DoD Chief Financial Officer's Statistical Sample Inventory Program was complete and accurate by requiring evidence of properly completed reconciliations between the Military Services' accountable property systems of record and the Distribution Standard System;
- use valid statistical criteria when determining the sample sizes; and
- use the same valuation methodology as the Military Services when assigning items in storage into dollar value groupings, including zero-valued items.

**DLA Response to Recommendation 2a:** Concur. The Executive Director, Logistics Policy and Strategic Programs and DORRA will coordinate to review and update SOP 4000.02-04 to incorporate obtaining evidence from the Military Services of completed reconciliations between appropriate Military Service systems and DSS



## Defense Logistics Agency Comments (cont'd)

**Specific actions taken or expected to be taken:** DLA will incorporate discussions about reconciliation with DSS into the upcoming coordination meetings between DLA and the Military Services on support to the Military Services' financial statement audits.

**Estimated Completion Date:** July 31, 2018

**DLA Response to Recommendation 2b:** Concur. The Executive Director, Logistics Policy and Strategic Programs and DORRA will coordinate to review and update SOP 4000.02 04 to incorporate use of a statistically valid criteria when determining samples sizes.

**Specific actions taken or expected to be taken:** DLA will incorporate discussions about statistically valid criteria for determining sample sizes into the upcoming coordination meetings between DLA and the Military Services on support to the Military Services' financial statement audits.

**Estimated Completion Date:** July 31, 2018

**DLA Response to Recommendation 2c:** Concur with comment. The Executive Director, Logistics Policy and Strategic Programs and DORRA concur that the sampling methodology should incorporate the valuation used by the Military Services. Since DLA does not have access to the valuation used by the Military Services, both organizations will coordinate with the Military Services to determine whether DLA or the Military Services is the best source to generate the samples for the annual CFO statistical sample inventory. Appropriate updates will be made to SOP 4000.02-04 based upon the outcome of the discussions

**Specific actions taken or expected to be taken:** DLA will incorporate discussions about reconciliation with DSS and best source for the sample into the upcoming coordination meetings between DLA and the Military Services on support to the Military Services' financial statement audits.

**Estimated Completion Date:** July 31, 2018

**Recommendation 3:** Director, Defense Logistics Agency, require that Defense Logistics Agency Office of Research and Resource Analysis personnel use the sampling methodology to design the sampling, select sample records, and project the results of the physical inventory counts consistent with the sample design.

**DLA Response to Recommendation 3:** Concur. The Executive Director, Logistics Policy and Strategic Programs and DORRA will coordinate to update the sampling methodology and design to ensure the end-to-end process is consistent.

**Specific actions taken or expected to be taken:** Conduct a comprehensive review incorporating the input from the Military Services and update the sample methodology and design.

**Estimated Completion Date:** July 31, 2018

# Acronyms and Abbreviations

<b>CFO</b>	Chief Financial Officer
<b>DLA</b>	Defense Logistics Agency
<b>DLM</b>	Defense Logistics Manual
<b>DORRA</b>	DLA Office of Research and Resource Analysis
<b>DSS</b>	Distribution Standard System
<b>PPS</b>	Probability Proportional to Size
<b>SOP</b>	Standard Operating Procedure

# **Whistleblower Protection**

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