

June 2000

DEFENSE INVENTORY

Army Needs to Strengthen and Follow Procedures to Control Shipped Items



G A O

Accountability * Integrity * Reliability

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Abbreviations

DOD	Department of Defense
GAO	General Accounting Office



B-282832

June 23, 2000

The Honorable Richard Durbin
The Honorable Tom Harkin
United States Senate

The Honorable Peter DeFazio
The Honorable Carolyn B. Maloney
House of Representatives

In response to your request, we reviewed the Army's procedures for tracking and controlling spare parts and other inventory items that have been shipped from one location to another to support military forces. Specifically, this report addresses (1) the extent to which the Army can identify inventory lost during shipment and (2) the Army's adherence to procedures for controlling shipped inventory.

This is one in a series of reports addressing defense inventory vulnerabilities to fraud, waste, and abuse. (A list of related GAO products appears at the end of this report.) Since at least 1990, our office has considered Department of Defense (DOD) inventory management to be a high-risk area because inventory management systems and procedures are ineffective. A lack of control over inventory shipments increases vulnerability to undetected loss and theft and substantially increases the risk that millions of dollars will be spent unnecessarily.

Control responsibility for the Army's inventory, including shipped inventory, is a shared responsibility of the Defense Logistics Agency, the Army Materiel Command and its four inventory control points, and Army-managed activities such as repair facilities. The Defense Logistics Agency operates and manages 22 storage depots; the depots receive, store, and issue Army inventory and maintain Army inventory records. The Army Materiel Command administers the Army's supply system and provides management policies and procedures for controlling shipped inventory. Through its four inventory control points, the Command initiates purchases for its customers and directs inventory movement to them from one of the Defense Logistics Agency's storage depots or vendors. To assess the Army's adherence to procedures, we primarily focused our work at the Aviation and Missile Command, which was responsible for the largest portion of the Army's shipped inventory.

Results in Brief

The Army does not know the extent to which shipped inventory is lost or stolen because of weaknesses in inventory controls and financial management practices. The Army reported inventory shipment losses of \$297,000 for fiscal year 1998. However, our analysis of available logistics and accounting records indicated that the Army could not account for about \$900 million in shipped inventory in fiscal year 1998. We found that many of the shipments we reviewed had in fact been received, but had not been documented in the required manner. This unaccounted for inventory included classified and sensitive items, such as guided missile components and night vision equipment.

Our review of shipments made during fiscal year 1998 indicates that Army personnel did not consistently follow required internal control procedures for shipped inventory. Specifically, Army units receiving inventory items have not always properly entered the receipt of shipments on inventory records, sent receipt acknowledgments to the inventory control point, or reported shipment discrepancies. Issuing units also have not consistently sent notifications of shipment cancellations. No dominant cause for failure to follow internal control procedures emerged in our discussions with Army officials. Poorly integrated accounting and logistics systems have led to inaccuracies regarding the status of shipped material. In addition, personnel at the Army's largest inventory control point have not adequately monitored receipts of items it reportedly purchased, and they have not adhered to federal policies and procedures for documenting follow up on material shipped to warehouses that have not been acknowledged as received. Moreover, from a broader perspective, the Army has not routinely assessed shipping discrepancies to maintain adequate oversight of shipped inventory.

To improve controls over the Army's shipped inventory, we are recommending that the Secretary of the Army (1) maintain accounting records to accurately report shipment losses; (2) maintain logistics records of unconfirmed shipments; (3) improve compliance with existing logistics procedures for controlling shipped inventory, and (4) monitor efforts to provide effective oversight needed to reduce the vulnerability of shipped inventory to undetected loss or misplacement. In written comments on a draft of this report, DOD agreed with all of our recommendations and outlined specific actions that the Army will take to address the recommendations.

Background

Each year, inventory worth billions of dollars is transported between Army units, storage depots, and suppliers. This inventory includes classified and sensitive items¹ (such as guided missile remote control systems, night vision equipment, and optical guided missile launcher sights) and pilferable items (items that are especially subject to theft because they can be readily resold or converted to personal use).

Inventory being transported between two locations typically involves the following types of material:

- End-user material—material ordered from a storage depot or commercial source by a unit that expects to use it.
- Returned material—excess end-user material returned to a storage depot.
- Warehoused material—material redistributed between storage depots.
- Purchased material—new material purchased but not yet received by a storage depot from a commercial source, other DOD services or agencies, non-DOD federal agencies, and foreign governments.

When an item is shipped, a shipping notification is sent to the receiving unit. The intended recipient of the material is responsible for notifying the inventory control point once the item has been received or if a discrepancy exists (e.g., the item was not received or the quantity received is less than that expected). The notification of receipt and discrepancy reporting processes are internal controls designed to account for all shipped assets. If within 45 days of shipment the inventory control point has not been notified that a shipment has arrived, it is required to follow up with the intended recipient. The rationale behind this requirement is that until receipt is confirmed, the exact status of the shipment is uncertain and therefore vulnerable to fraud, waste, and abuse.

Extent of Shipped Inventory Loss Cannot Be Determined

The Army does not know the exact extent to which shipped inventory is lost or stolen because of weaknesses in inventory controls and financial management practices. The Army records show shipment losses of about \$297,000 during fiscal year 1998. However, our review of available records

¹ Classified items are those that require the highest degree of protection in the interest of national security. Sensitive items are those that require a high degree of protection and control because of their high value and/or hazardous or technical nature.

indicated that the Army had lost at least another \$29.5 million that was not specifically identified as shipment losses during fiscal year 1998. Army records also showed additional items valued at \$883 million had been shipped but were not acknowledged as received. Some of these shipments that had not been acknowledged as received may represent additional lost or stolen items. Shipments reported as lost or unaccounted for include (1) classified items that require the highest degree of protection in the interest of national security and (2) sensitive items that warrant a high degree of protection and control because of their high value and/or their hazardous or highly technical nature.

**Accounting and Inventory
Management Practices
Obscure Extent of Losses**

While the Army has reported shipment losses and available records indicate that the Army may have incurred additional losses that were not reported as such, its underlying records are not sufficiently reliable to determine the extent of losses actually incurred. As part of our audit of DOD's fiscal year 1998 financial statements, we found continuing problems with DOD's inventory management and control systems and practices that affected its ability to maintain accurate and complete inventory data. Specifically, we testified that auditors were unable to confirm the amount of reported shipped inventory. The auditors identified weaknesses that, in addition to hampering financial reporting, impaired the Department of Defense's ability to safeguard these assets from theft or loss. For example, the Army Audit Agency reported that they could not determine the reasonableness of almost \$600 million of the Army's reported inventory shipments of purchased material.²

² *Department of Defense: Status of Financial Management Weaknesses and Actions Needed to Correct Continuing Challenges* (GAO/T-AIMD/NSIAD-99-171, May 4, 1999).

The Army's accounting management practices obscure the full extent of items lost during shipment. For fiscal year 1998, the Army reported shipment losses totaling \$296,577 based on information recorded in its accounting records under an account titled "incoming shipments loss account". This account is intended for inventory losses resulting from shortages in shipments, and it is used by only a few Army depots.³ Shortages in Army shipments to Defense Logistics Agency warehouses are recorded in its accounting records under an account titled "accounting adjustments loss account," which totaled about \$2.2 billion for fiscal year 1998. This account is intended for losses resulting from differences between inventory balances at the depot and the inventory control point.

To determine what portion of the \$2.2 billion related to shipment losses, we reviewed accounting records from three of the Army's four inventory control points.⁴ Using shipment tracking codes, we identified shipment losses of \$29.5 million in the accounting adjustments loss account.

When we informed Army officials that shipment losses had been reported as inventory accounting adjustments, they pointed out that Army policies did not preclude them from processing and reporting shipment losses in accounting records as something other than lost shipments. However, the Department of Defense Financial Management Regulation for supply activities states that separate accounts may be established and used to capture recurring and significant inventory events. Having losses during shipments reported in two different accounts, one of which also contains other types of loss, impairs the Army's ability to fully use its accounting records to account for shipment losses.

The Army's inventory management practices also obscure the full extent of items lost during shipment. When an inventory control point directs a shipment to end users (e.g., Army units), the inventory control point is required to track the shipment and the end user is required to acknowledge receipt of the item. After a specified period of time, inventory control points are required by Department of Defense and Army policy to close their logistics records on outstanding shipments to and from Army end

³ In 1992, the Defense Logistics Agency took over management of the Army's storage depots, but the Army continues to manage several depots itself.

⁴ The Aviation and Missile Command, the Communications-Electronics Command, and the Tank-automotive and Armaments Command. Comparable records were not readily available at the Soldier and Biological Chemical Command.

users even when the intended recipient did not acknowledge receipt of the shipment. For fiscal year 1998, Army logistics records for all inventory control points indicate that items worth about \$862.6 million had not been acknowledged as received—some portion of which could have been lost or stolen. These shipments included items shipped to end users and material returned to storage depots. Table 1 shows the shipments that were outstanding for more than 90 days without a notification of receipt.

Table 1: Shipments Without a Notification of Receipt for Fiscal Year 1998

Dollars in millions

Shipment type	Number of shipments	Value	Actual time outstanding for each shipment
End-user material	738,094	\$846.4	over 90 days
Returned material	2,169	16.2	over 160 days
Total	740,263	\$862.6	

Source: Army Logistics Intelligence File and Material Returns Data Base.

The Army does not maintain accounting records for purchased material that are comparable to end-user and returned material.⁵ However, as of May 31, 1999, the Aviation and Missile Command reported that unacknowledged shipments of purchased material totaled over \$62.2 million, of which \$20.1 million had been unacknowledged from 60 days to over 4 years. Although these items are not necessarily lost, they are vulnerable to loss as long as they remain unaccounted for.

Lost and Unaccounted for Shipments Include Classified and Sensitive Items

Our review showed that the Army's inability to track lost and unacknowledged shipments affects thousands of shipments, including classified and sensitive items. We reviewed 5,283 shipments reported as lost or unaccounted for (representing 203,837 items worth about \$400 million) in fiscal year 1998 to identify the types of shipped items

⁵ The Army's accounting and logistics system does not record shipments of purchased material on a shipment by shipment basis. In addition, the shipments identified in table 1 did not include warehoused material (i.e., material distributed between storage depots) because the Army's system does not retain records on the number of, value of, or reasons for unconfirmed shipments of warehoused material, nor does it archive this data for future reference.

involved. Our review included (1) all 2,045 shipment losses reported in the inventory accounting adjustment loss account (valued at \$29.5 million), (2) all 1,069 shipments of end-user material valued at over \$100,000 each that were outstanding for more than 90 days without a notification of receipt (valued at \$354.9 million), and (3) all 2,169 shipments of returned material that were outstanding for more than 160 days without a notification of receipt (valued at \$16.2 million). Our review showed that about 3,000 (58 percent) of these shipments contained nonsensitive items valued at \$188.1 million. However, about 1,800 shipments (35 percent) contained classified items (valued at \$185.4 million) such as guided missile remote control systems and sensitive items (valued at \$4 million) such as night vision equipment and optical guided missile launcher sights. The remaining 358 shipments (7 percent) contained pilferable items such as panel clocks and tire wheels and items that were not identified by type of security classification. Table 2 shows the security type, number of items, and dollar value of sample shipments reported as lost or unaccounted for.

Table 2: Type of Shipments Reported as Lost or Unaccounted for in Fiscal Year 1998

Dollars in millions

Type	Number of shipments	Number of items	Value
Classified military items	1,816	58,428	\$185.4
Sensitive military items	50	2,204	4.0
Pilferable items	269	42,199	21.0
Nonsensitive items	3,059	100,074	188.1
Items with unknown security classification	89	932	2.0
Total	5,283	203,837	\$400.5

Source: GAO analysis.

Procedures for Controlling Shipped Items Are Not Followed or Are Ineffective

As a result of several significant inventory control weaknesses, the Army's shipped inventory is highly vulnerable to loss or theft. Army units have not adequately recorded and reported receipt and return of items to the inventory control point as required. In addition, our work at a primary inventory control point, the Aviation and Missile Command, indicated that the Command had not adequately followed up on delinquent receipt notifications for purchased items or maintained records of warehoused

material shipment losses. Overall, the Army and its Army Material Command have not routinely monitored and assessed shipping discrepancies as required, and they lack sufficient and reliable information for such assessments.

Procedures for Processing Shipments Not Always Followed

The Department of Defense and Army regulations contain specific internal control procedures to help ensure that shipped inventory is controlled. The regulations require that, upon receipt of an item, a receiving unit enter the shipment into its inventory records and notifies the inventory control point within 5 calendar days that the items were received in full or that a discrepancy exists between the items ordered and the items received. When a discrepancy is identified and reported by the receiving unit, the inventory control point is required to initiate research to resolve the circumstances surrounding the discrepancy. In situations when end users have excess inventory on hand and it is determined that the material is needed elsewhere, an inventory control point is required to direct them to return the material to a storage depot. When returning material, the end users are to send a shipping notification to the inventory control point. When the storage depot receives the shipment, it is required to record its receipt and notify the inventory control point within 10 days that the material has been received. If the material is not shipped to the depot, end users are to submit a cancellation notice to the inventory control point. These procedures are consistent with the federal government standard for internal controls that requires accurate, complete, and timely recording of transactions and events.⁶

As we previously indicated, end-user and returned material shipments valued at \$862.6 million and purchased items valued at \$20.1 million had not been acknowledged as received. Army officials told us that the lack of proper receipt notifications for shipped inventory items does not necessarily mean that the items were lost or stolen. They stated that, in most cases, the items were probably received but not reported as being received because Army units or depots did not (1) notify the inventory control points that they received the items as required by Army regulations or (2) respond to follow-up inquiries made by the inventory control points. As part of our review, we sought to determine whether such items had in

⁶ *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21-3.1, Nov. 1999).

fact been received and to identify reasons why their receipts were not reported to the relevant inventory control point.

Our review indicated that receiving units had not adequately recorded and reported receipt of items, and some items had not in fact been received. Of the \$883 million of inventory shipped but not acknowledged as received, we selected 81,151 items (valued at \$45.1 million) for review.⁷ We found that 11,558 of these items (valued at \$4 million) could not be accounted for because Army units had not detected or reported shipment discrepancies at the time of our review. The remaining 69,593 items (valued at \$41.1 million) were actually received, but erroneously remained on the Army's record as unaccounted for because they had not been processed in the required manner.

Specifically, 54,189 of the 69,593 items (valued at over \$28.5 million) had in fact been received but were considered unaccounted for because Army units reported receipt of the items using incorrect receipt acknowledgment codes. Army officials at one location—which was responsible for the largest portion of the unaccounted for shipments in our sample—said that incorrect receipt acknowledgement codes were used because the Army had not yet changed its automated logistics system and procedures to conform with DOD's receipt acknowledgement codes. Poorly integrated accounting and logistics systems following the merger of two inventory control points also contributed to faulty receipt acknowledgment reporting.⁸ For example, the Army's general ledger system, which ties its accounting systems to its logistics and other key management systems and is used to identify the receipt of shipments, did not update both accounting and logistics records with purchased material receipts.

⁷ We selected end-user and returned material items at Army units that had a high incidence of unacknowledged receipts. Our review included 80,635 end-user items valued at over \$100,000 each that had been outstanding over 90 days without a notification of receipt (valued at \$39.7 million) and 393 returned material items that had been outstanding over 160 days without a notification of receipt (valued at \$2.4 million). We selected 123 purchased items to review that had been outstanding from over 60 days to 4 years without a notification of receipt (valued at \$3 million).

⁸ Our prior reports have pointed out similar deficiencies in DOD's existing accounting and related systems, including its logistics systems. See *Defense Inventory: Navy's Procedures for Controlling In-transit Items Are Not Being Followed* (GAO/NSIAD-99-61, Mar. 31, 1999), *High-Risk Series: Defense Financial Management* (GAO/HR-97-3, Feb. 1997), and *Inventory Management: Vulnerability of Sensitive Defense Material to Theft* (GAO/NSIAD-97-175, Sept. 19, 1997).

The remaining 15,404 items (valued at \$12.7 million) were unaccounted for because Army units either did not (1) record the receipt of shipments on inventory records, (2) routinely report receipt of shipments to the inventory control point, or (3) properly notify the inventory control point when shipments of returned material were canceled. These three types of problems were identified at most of the Army units we reviewed. No dominant cause for these failures to follow procedures emerged in our discussions with Army unit and depot officials. However, in our interviews with end-user personnel, some of them said that they were not familiar with the shipment processing procedures we had asked them about. Without proper receipt notification and discrepancy reporting, the Army has no reasonable assurance that at least some of the items are not lost or stolen. Appendix II summarizes by material type the Army's explanation of issues that impaired the Army's visibility over these shipments and made them vulnerable to theft and loss.

**Inventory Control Point
Follow-Up on Shipments of
Purchased Items Not
Adequate**

DOD policies require the inventory control point to follow up on unconfirmed receipts of shipped items and on shipment discrepancies, but our work at the Aviation and Missile Command shows that it had not adequately complied with these policies. To ensure proper reporting and accounting of material receipts, DOD requires inventory control points to follow up on overdue shipments with the intended recipient within 45 days from the date of shipment. As previously shown, the Aviation and Missile Command had not followed up on \$20.1 million of purchased shipments outstanding as of May 31, 1999, which had not been acknowledged for 60 or more days. During our work at the Aviation and Missile Command, material and financial management officials told us that they were not aware of specific DOD or Army procedures for researching outstanding shipments of purchased material, assigning responsibility for carrying out these procedures, and prescribing related accountability.

As we previously mentioned, at the end of May 1999, the Aviation and Missile Command reported unacknowledged shipments of purchased material valued at \$62.2 million, of which \$20.1 million had been outstanding from 60 days to over 4 years. At the Aviation and Missile Command, we judgmentally selected and reviewed reported shipments of purchased material (valued at \$4.6 million) that were over 60 days old to determine the nature and extent of the Command's follow-up efforts. Among the internal controls that DOD requires the Army to incorporate in their accounting systems is reconciliation of receipt and payment data to ensure that (1) material paid for is received and (2) payments are recovered

for items the Army never receives. We found that the Aviation and Missile Command had not reconciled the financial records that identified these shipments as overdue with inventory records. As a result, no follow-up research was initiated by the Aviation and Missile Command to track these shipments. We reviewed the Command's receipt and payment data and found that over \$3 million of these outstanding shipments represented shipments of purchased material that had actually been received. Of the remaining \$1.6 million, we identified the following discrepancies:

- Payments in the amount of \$1,319,357 for purchased items were recorded incorrectly. According to an Aviation and Missile Command official, these payments included duplicate payments for some purchased material transactions and payments against the wrong contract line items for other transactions.
- Records for two shipments of purchased material valued at \$234,685 were unavailable to determine whether or not these materials represented actual shipments. One shipment had been outstanding for over 4 months and the other for more than 4 years. We were told that contract files were unavailable because they were either retired to storage or could not be located.
- A payment of \$56,242 was made for an item never received in the Army's inventory. In this case, the item recorded as outstanding purchased material in the Aviation and Missile Command's automated financial records had been shipped to the Aviation and Missile Command's test and evaluation lab for inspection. The item failed inspection, and the Aviation and Missile Command terminated the contract for default in August 1998. When we informed Aviation and Missile Command officials that the contractor had been paid for the item in August 1997, they said that the contractor should not have been paid. In June 1999, the Defense Finance and Accounting Service issued a demand letter requesting the erroneous payment be returned.
- The Aviation and Missile Command's records indicated that shipments of purchased material (valued at \$21,257) were outstanding, but in fact there were no such shipments. Instead, expenses of \$21,257 had been incurred to terminate a contract for nine items and were erroneously processed as outstanding purchased material. According to an Aviation and Missile Command official, action was taken in July 1999 to correct the invalid record of purchased material.

These examples are similar to problems previously identified in a May 1997 report from the Army Audit Agency on the Army's fiscal year 1996 Defense Business Operations Fund Financial Statements. To improve controls over

shipments of purchased material, the Army Audit Agency recommended that the Assistant Secretary of the Army (Financial Management and Comptroller), in coordination with the Defense Finance and Accounting Service, develop a memorandum of understanding that would (1) clarify each activity's goals and what they require to accomplish the goals, (2) explain the interrelationship of the financial and logistical systems and the importance of transactions being entered and cleared from both records, and (3) require a person in each activity to provide an avenue for continued improvements in the working relationship and interrelated processes. The Office of the Assistant Secretary agreed to these recommendations, but as of April 2000, the Office acknowledged that it had not yet taken recommended actions but planned to do so by October 2000.

Controls Over Unaccounted for Warehoused, End-User, and Returned Material Shipments Are Impaired

We could not assess Aviation and Missile Command follow up on warehoused material shipments because the Army system does not retain records of unconfirmed warehoused material, and the records cannot be reconstructed. This lack of documentation is in itself an internal control weakness. Among the federal government's standards for internal controls is the need to clearly document transactions and to have that documentation readily available for examination. Aviation and Missile Command officials told us that prior to deleting such records, they extensively researched the items to ensure that the warehoused material was actually received. However, they acknowledged that documentation was not maintained of their research results.

We did not assess the Aviation and Missile Command's follow-up of end-user receipt of shipments because, under current DOD policy, inventory control points simply assume that material shipped to end users is received by them. After 90 days, whether or not they have confirmation of material receipt, inventory control points close the shipment on their records. They become aware that material has not been received only if the intended recipient inquires about the shipment. Similarly, we did not assess the Aviation and Missile Command's follow-up of returned material because, under Army policy, the inventory control points assume material returned from end users was never shipped. After 210 days, inventory control points no longer carry the records of returned material shipments, assuming that they have not been shipped.

In the course of our review of end-user receipt acknowledgment practices, we found some examples in which the inventory control point closed the records on shipments even though all items had not been accounted for. In

one case, the end user expected a shipment of one rotary wing blade (valued at \$102,259), but did not receive the shipment. The end user did not report the discrepancy to the Aviation and Missile Command (the relevant inventory control point), and after 90 days, the Aviation and Missile Command closed its record on the shipment, assuming the wing blade had been received. Similarly, we identified six shipments of returned material (valued at \$10,437) that the Aviation and Missile Command had assumed had not been shipped and had been closed out. However, the material remains unaccounted for even though it had been shipped.

As long as accountability is transferred to the customer in this way, inventory control points have little motivation to follow up on and resolve unacknowledged end-user and returned shipments. The result is a situation in which unaccounted for end-user shipments are officially considered delivered (or returned material not shipped), an assumption which in turn places this material at risk of fraud, waste, abuse, and theft.

Army Program Oversight Is Insufficient

The Army Materiel Command and the Aviation and Missile Command have not been routinely assessing shipping discrepancies between various logistics records as required to maintain proper program oversight. To assess supply operations, Army policy requires inventory control points to record, summarize, and report to a single point within the Army (i.e., the Army Materiel Command) the volume and dollar value of shipment discrepancies, including shipment shortages and shipment nonreceipts. The policy requires the Army Materiel Command to analyze data from logistics records for the purpose of identifying the cause, source, and magnitude of discrepancies in shipped inventory so that corrective actions can be taken. This policy is consistent with the federal government standards for internal control that require ongoing monitoring to assess the quality of performance over time and to ensure that the findings of audits and other reviews are promptly resolved.

While reviewing fiscal year 1998 logistics record shipment discrepancies, we found that the Aviation and Missile Command had not summarized the required data, and the Army Materiel Command had not asked for the required data. Even if the Aviation and Missile Command had summarized the data, it probably would not have produced meaningful results. Our review showed that items included in the shipment shortage and shipment nonreceipt category at the Aviation and Missile Command turned out to be other types of shipping, packaging, and transportation discrepancies. As a result, the data needed to identify the cause, source, and magnitude of

shipment discrepancies were not reliable and could not be used for these purposes. The lack of this information impedes the Army's ability to determine which activities are responsible for lost or misplaced items.

In addition, the Army's accounting and logistics systems are not effectively integrated for discrepancy assessments. Establishing such an integrated, general ledger controlled system that ties together the Army's accounting and logistics systems is critical to effectively overseeing inventory shipments. Such an integrated system structure is required by the Chief Financial Officers Act of 1990. When accounting and logistics systems are effectively integrated, both sets of records are automatically updated with transaction data on a shipment-by-shipment basis—the accounting records with summary level data and the logistics records with detailed transaction data. Any differences between these two sets of records should be periodically identified and research conducted to alert management to a possible undetected loss or theft of shipped items.

A breakdown in controls over purchased material receipts is illustrative of the problems created by not effectively linking accounting and logistics records. For example, Aviation and Missile Command officials explained that they were not alerted to receipts of purchased items because existing systems did not automatically update both accounting and related logistics records. Failure to automatically update these two sets of records results in unreconciled discrepancies which reduces the reliability of reported inventories, losses, and on-hand balances.

As part of the Department of Defense's 1999 Financial Management Improvement Plan,⁹ the Department has stated that it is developing systems that will meet the federal government's financial management systems requirements. If properly designed and implemented as part of a Department of Defense-wide system structure that will provide general ledger control, such a structure will help to effectively oversee the Army's inventory shipments.

⁹ Under section 1008 of the National Defense Authorization Act for Fiscal Year 1998 (Public Law 105-85), the Department is to submit to the Congress its strategic plan for improving financial management. The Department's Financial Management Plan was dated September 1999.

Conclusions

Because of weaknesses in its internal controls and financial management practices, the Army does not know the extent of its inventory shipment losses and has not sufficiently tracked and controlled inventory shipments. For months and even years at a time, inventory worth millions of dollars goes unaccounted for because Army units fail to record and report receipt of items. Also, the primary inventory control point has failed to follow up on delinquent shipments and maintain records of shipment losses in accordance with established internal control procedures, even when classified or sensitive items are involved. The Army and its Materiel Command have not sufficiently assessed practices for safeguarding shipped inventory and weaknesses in the Army's ability to adequately oversee and protect shipped inventory places it at risk of waste, fraud, or abuse.

More specifically, Army personnel have (1) mixed numerous shipment losses in with other inventory adjustments, masking the extent of such losses; (2) not retained the proper records associated with unconfirmed warehoused shipments; (3) not carried out existing Army and Defense Department logistics procedures for controlling shipped inventory; and (4) not provided adequate oversight to safeguard shipped inventory. The cumulative result has been that about \$900 million worth of shipped inventory, including classified and sensitive items, is unaccounted for and is vulnerable to loss or theft.

Recommendations

To acquire accurate and complete data on inventory losses and to improve the control of inventory being shipped, we recommend that the Secretary of Defense direct the Secretary of the Army to

- revise accounting procedures in order to establish a separate account to capture all shipment losses in one place;
- modify the Army's logistics and accounting systems so that they retain records of unconfirmed warehoused material shipments consistent with federal internal control standards;
- emphasize to the Army Materiel Command, Aviation and Missile Command, and Army unit personnel the need to comply with existing Army and DOD internal control procedures for shipped inventory; and
- maintain proper program oversight as required to reduce the vulnerability of shipped inventory to undetected loss or misplacement.

Agency Comments

In written comments on a draft of this report, DOD agreed with all of our recommendations and stated that the Army will work with the Defense Logistics Agency and the Defense Finance and Accounting Service to resolve the issues. DOD outlined specific actions that the Army will take to address our recommendations. First, DOD stated that our recommendation to capture all shipment losses in one place will require extensive evaluation and study to determine the most cost-effective solution to this recommendation. The potential solution will be applied to the Army's Logistics Systems Modernization effort and will entail changes to the Defense Finance and Accounting System. Second, the Army is in the process of changing its automation systems so that they retain records of unconfirmed warehoused material shipments consistent with federal internal control standards. Third, the Army will publish guidance Army-wide emphasizing the need to comply with existing Army and DOD internal control procedures for shipped inventory. Lastly, the Army will increase oversight of shipped inventory to reduce the vulnerability of such inventory to undetected loss or misplacement.

Appendix I contains the scope and methodology for this report. DOD's written comments on this report are reprinted in their entirety in appendix III.

As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to the Honorable William Cohen, Secretary of Defense; the Honorable Louis Caldera, Secretary of the Army; Lieutenant General Henry T. Glisson, Director, Defense Logistics Agency; and the Honorable Jacob Lew, Director, Office of Management and Budget.

If you or your staff have any questions regarding this report, please contact me at (202) 512-8412. GAO contacts and key contributors to this report are listed in appendix IV.

A handwritten signature in black ink that reads "David R. Warren". The signature is written in a cursive style with a long horizontal line extending to the right.

David R. Warren, Director
Defense Management Issues

Objectives, Scope, and Methodology

Our objectives for this report were to determine (1) the extent to which the Army can identify inventory lost during shipment and (2) the Army's adherence to procedures for controlling shipped inventory. To determine the extent to which the Army could identify inventory lost during shipment, we took the following steps:

- We reviewed Department of Defense and Army policies and procedures and obtained other relevant documentation related to shipped inventory, and we discussed financial inventory accounting and management procedures with officials at the following locations: (1) Headquarters, Department of the Army, Arlington, Virginia; (2) Headquarters, U.S. Army Materiel Command, Alexandria, Virginia; (3) the Logistics Systems Support Center, St. Louis, Missouri; (4) the Logistics Support Activity, Redstone Arsenal, Alabama; (5) the Defense Finance and Accounting Service, Indianapolis, Indiana; (6) the Defense Finance and Accounting Service, St. Louis, Missouri; and (7) the Defense Finance and Accounting Service, Columbus, Ohio.
- We obtained computerized financial records of all inventory shipment losses reported in the Army's incoming shipments loss account between October 1997 and September 1998 from the Defense Finance and Accounting Service in Indianapolis, Indiana. We also obtained available financial records of all transactions reported in the Army's accounting adjustments loss account between October 1997 and September 1998. Using shipment tracking codes, we identified all shipment losses that were reported in the accounting adjustments loss account from the Defense Finance and Accounting Service in St. Louis, Missouri. At the Logistics Support Activity, we obtained computerized inventory records of all end-user shipments to Army activities and returned material shipments from Army activities between October 1997 and September 1998 that had not been acknowledged as received. At the Aviation and Missile Command, we obtained financial reports of purchased material shipments that were outstanding as of May 31, 1999, the most current and complete shipment information available.
- To determine the security type of selected shipments reported as lost or unaccounted for in fiscal year 1998, we identified the national stock number for (1) all shipments reported in the inventory accounting adjustment loss account as lost, (2) all shipments of end-user material valued at over \$100,000 that were outstanding for more than 90 days without a notification of receipt, and (3) all shipments of returned material that were outstanding for more than 160 days without a notification of receipt. We then matched the national stock number with

security classification codes in the Department of Defense Federal Logistics Information System.

To assess the Army's adherence to procedures for controlling shipped inventory, we took the following steps:

- Using the computerized data obtained from the Logistics Support Activity and the Aviation and Missile Command, we judgmentally selected and reviewed 81,151 end-user, returned, and purchased items that were not reported as received. We selected end-user and returned material items at selected Army units that had a high incidence of unacknowledged receipts. Our review included 80,635 end-user items valued at over \$100,000 each that had been outstanding over 90 days without a notification of receipt and 393 returned material items that had been outstanding over 160 days without a notification of receipt. For purchased material items, we selected 123 items to review that had been outstanding from over 60 days to 4 years without a notification of receipt. We did not independently verify the overall accuracy of the databases from which we obtained data, but used them as a starting point for selecting shipments that we then tracked back to records and documents on individual transactions.

For the sample items, we reviewed available computer-generated shipment and receipt data, analyzed inventory records, and held discussions at the Aviation and Missile Command; Corpus Christi Army Depot, Corpus Christi, Texas; Defense Distribution Depots (located in Susquehanna, Pennsylvania; McClellan Air Force Base, California; and Tobyhanna, Pennsylvania); Red River Army Depot, Texarkana, Texas; Letterkenny Army Depot, Chambersburg, Pennsylvania; Defense Automated Addressing System Office, Dayton, Ohio; U.S. Army Aviation Center, Fort Rucker, Alabama; COBRO Corporation, Huntsville, Alabama; National Guard Bureau, New Orleans, Louisiana; U.S. Army Air Defense Artillery Center, Fort Bliss, Texas; Tennessee Army National Guard, Nashville, Tennessee; the National Guard Bureau, Augusta, Maine; Florida Army National Guard, Jacksonville, Florida; Mississippi Army National Guard, Gulfport, Mississippi; Hunter Air Force Base, Savannah, Georgia; Sikorsky Aircraft, Stratford, Connecticut; and U. S. Army Forces Command, Fort McPherson, Georgia.

- To learn whether issues associated with overdue shipments were adequately resolved, we reviewed Department of Defense, Army, and Aviation and Missile Command implementing guidance. Such

information provided the basis for conclusions regarding the adherence to procedures for controlling shipped inventory.

- To determine whether the Army had emphasized shipped inventory as part of its assessment of internal controls, we reviewed assessments from the Aviation and Missile Command for fiscal year 1998, the Army Missile Command for fiscal years 1996-97, and the Department of the Army for fiscal years 1995-98.

We performed our review from April 1999 through April 2000 in accordance with generally accepted government auditing standards.

Description of Weaknesses That Impaired the Army's Control Over Shipments

Type of material	Number of shipments	Number of items	Value
End-user material			
End users reported receipt of items using incorrect receipt acknowledgment codes	52	54,112	\$25,713,018
End users received but did not enter items into inventory records	6	15,005	1,989,250
End users entered items into inventory records, but did not send a receipt notification to the inventory control point	29	109	8,959,348
End users did not detect or research and report shipment discrepancies	6	11,409	3,015,705
Subtotal	93	80,635	39,677,320
Returned materials			
Storage depots reported receipt of material using wrong receipt acknowledgment codes	4	6	21,029
Storage depot did not report receipt of shipment	3	19	138,698
End users did not reconcile discrepancies by following up on inquiries when returned items were not received at the storage depot	6	12	10,437
End users did not notify inventory control point of shipment cancellation	26	249	381,113
End users sent items to wrong storage depot	8	8	1,177,419
End-user records lack sufficient documentation to prove that items had been returned	29	85	605,261
Storage depot used correct receipt acknowledgment code, but inventory control point records did not reflect receipt	10	14	76,051
Subtotal	86	393	2,410,009
Purchased materials			
Storage depots reported receipt of shipment using the wrong receipt acknowledgment code	Unknown ^a	48	848,389
Recipients—foreign military customers and depots—did not confirm receipt of items or shipment discrepancies	Unknown	46	304,900
Poorly integrated accounting and logistics systems—following the merger of two inventory control points—resulted in faulty receipt reporting	Unknown	23	1,876,944
Storage depots made recording errors that prevent the inventory control point from determining the status of shipped items	Unknown	6	6,546
Subtotal	Unknown	123	3,036,779
Total	179	81,151	\$45,124,108

Note: Dollar values do not add due to rounding.

^aThe Army's accounting and logistics system does not record shipments of purchased material on a shipment by shipment basis.

Comments From the Department of Defense



ACQUISITION AND
TECHNOLOGY

(L/LSM)

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

JUN 6 2000

Mr. David Warren
Director, Defense Management Issues
National Security and International Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Warren:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DEFENSE INVENTORY: Failure to Follow Inventory Control Procedures Leave Shipped Army Items Vulnerable to Loss," Dated April 19, 2000 (GAO Code 709405/OSD Case 1985). The Department concurs with the recommendations in the draft report. The Department of the Army has agreed to work with the Defense Logistics Agency and the Defense Finance and Accounting Service to resolve these issues.

The Department's detailed comments to the recommendations are enclosed. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

A handwritten signature in black ink that reads "Roger W. Kallock".

Roger W. Kallock
Deputy Under Secretary (Logistics)

Enclosure



GAO DRAFT REPORT - DATED APRIL 19, 2000
(GAO CODE 709405) OSD CASE 1985

“DEFENSE INVENTORY: FAILURE TO FOLLOW INVENTORY
CONTROL PROCEDURES LEAVE SHIPPED ARMY ITEMS VULNERABLE
TO LOSS”

DEPARTMENT OF DEFENSE COMMENTS TO THE
RECOMMENDATIONS

The GAO recommended the Secretary of Defense direct the Secretary of the Army to:

RECOMMENDATION 1: Revise accounting procedures in order to establish a separate account to capture all shipment losses in one place;

DOD RESPONSE: The GAO recommendation “to capture all shipment losses in one place” will require extensive evaluation and study to determine the most cost-effective solution to this recommendation. The potential solution will be applied to the Army’s Logistics Systems Modernization effort during development. This will also entail changes to the Defense Finance and Accounting System (DFAS).

RECOMMENDATION 2: Modify the Army’s logistics and accounting systems so that they retain records of unconfirmed warehouse material shipments consistent with federal internal control standards;

DOD RESPONSE: The Army is in the process of changing its automation systems – Global Combat Support System – Army (GCSS-A) will encompass both the retail and strategic logistics process. The Army recently awarded the contract for Wholesale Logistics Modernization Program (WLMP). This requirement will be levied on both systems.

RECOMMENDATION 3: Emphasize to the Army Materiel Command, Aviation and Missile Command and Army unit personnel the need to comply with existing Army and DoD internal control procedures for shipped inventory; and

DOD RESPONSE: : The Army will publish guidance Army-wide emphasizing the need to comply with existing Army and DoD internal controls and procedures for shipped inventory.

RECOMMENDATION 4: Maintain proper program oversight as required to reduce the vulnerability of shipped inventory to undetected loss or misplacement.

DOD RESPONSE: The Army will increase oversight of this essential program.

GAO Contacts and Staff Acknowledgments

GAO Contacts

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Lawson Gist, Jr. (202) 512-4478

Acknowledgments

In addition to the above contacts, Sandra F. Bell, Carleen C. Bennett, Joseph F. Murray, Jeanett H. Reid, Robert C. Sommer, and Susan K. Woodward made key contributions to this report.

Related GAO Products

Defense Inventory: Plan to Improve Management of Shipped Inventory Should Be Strengthened (GAO/NSIAD-00-39, Feb. 22, 2000).

Department of the Navy: Breakdown of In-Transit Inventory Process Leaves It Vulnerable to Fraud (GAO/OSI/NSIAD-00-61, Feb. 2, 2000).

Defense Inventory: Property Being Shipped to Disposal Is Not Properly Controlled (GAO/NSIAD-99-84, July 1, 1999).

Defense Inventory: Navy's Procedures for Controlling In-Transit Items Are Not Being Followed (GAO/NSIAD-99-61, Mar. 31, 1999).

Performance and Accountability Series: Major Management Challenges and Program Risks—Department of Defense (GAO/OCG-99-4, Jan. 1999).

High-Risk Series: An Update (GAO/HR-99-1, Jan. 1999).

Department of Defense: Financial Audits Highlight Continuing Challenges to Correct Serious Financial Management Problems (GAO/T-AIMD/NSIAD-98-158, Apr. 16, 1998).

Department of Defense: In-Transit Inventory (GAO/NSIAD-98-80R, Feb. 27, 1998).

High-Risk Series: Defense Inventory Management (GAO/HR-97-5, Feb. 1997).

High-Risk Series: Defense Financial Management (GAO/HR-97-3, Feb. 1997).

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