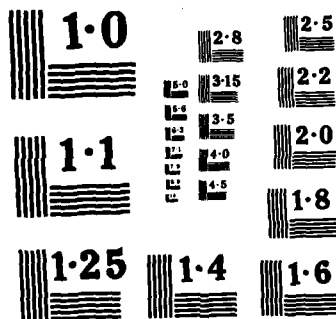


AD-A156 293 THE NAVY CAN INCREASE CANCELLATIONS OF PROCUREMENTS FOR 1/1  
UNNEEDED MATERIAL(U) GENERAL ACCOUNTING OFFICE  
WASHINGTON DC NATIONAL SECURITY AND. 22 MAR 85  
UNCLASSIFIED GAO/NSIAD-85-55 F/G 15/5 NL





NATIONAL BUREAU OF STANDARDS  
MICROCOPY RESOLUTION TEST CHART



UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

NATIONAL SECURITY AND  
INTERNATIONAL AFFAIRS DIVISION

MARCH 22, 1985

B-217670

The Honorable John F. Lehman  
The Secretary of the Navy

Dear Mr. Secretary:

Subject: The Navy Can Increase Cancellations Of  
Procurements For Unneeded Material  
(GAO/NSIAD-85-55)

Our review of the Navy's procedures and practices for canceling procurements of unneeded material showed that cancellations can be increased, thereby reducing unnecessary procurement and inventory investment costs. Our review of cancellations during May 1983, the most current month available at the start of our review, showed that potentially excess procurements identified by the inventory control points totaled \$293 million. Our tests of possible termination actions for that month showed that less than one percent was actually canceled.

Although we are not suggesting that all of the potentially excess procurements should be canceled, we believe cancellations can be much higher. The following are the principal reasons cancellations are not higher.

- The inventory control points have established high dollar review thresholds.
- The inventory control points apply protection levels to provide an added buffer against running out of stock.
- Inventory managers do not always act on cancellation notices in a timely manner.
- Management and supervisory attention over the cancellation process is limited.

PROCEDURES FOR IDENTIFYING AND  
CANCELING EXCESS MATERIAL

The two Navy inventory control points--Aviation Supply Office (ASO) and Ships Parts Control Center (SPCC)--use the

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Uniform Inventory Control Point system to compute requirements for material needed to fill customer requisitions and to meet other obligations. The automated system also compares the computed requirements with the material on hand and on order. Changes in item usage, production leadtimes, repair cycles, and other factors can reduce current requirements and cause material on hand and on order to become excess to the Navy's current needs. When this situation occurs, the automated system generates a termination notice for all excess quantities on order with dollar values above limitations established by each inventory control point.

Termination notices are reviewed by inventory managers for possible cancellation of procurements. In making the review, they are to validate the accuracy of the data used in computing the excesses and, if necessary, make changes to the data files. Once the review is completed, the inventory managers take one of the following actions:

- Approve the computer-generated termination quantities for possible cancellation.
- Reduce the termination quantities on the basis of their data validation review and approve the balance for possible cancellation.
- Reject the termination notice on the basis of their data validation review and not approve any quantities for possible cancellation.

Approved termination quantities are forwarded to the purchasing division for possible cancellation. The purchasing division then decides whether cancellation should be attempted. If the purchase request is still in a preaward status, cancellation action can be taken internally at little or no cost. If the excess material is under contract, the purchasing division must contact the contractor to ascertain the termination costs and delivery schedule and determine if it is economical to take cancellation action.

#### OBJECTIVE, SCOPE, AND METHODOLOGY

Although the requirements computation process generally is the same at both inventory control points, the termination procedures and practices covering such matters as review limitations and review timeframes are unilaterally established by each inventory control point. Our primary objective was to determine the effectiveness of these procedures and practices in identifying and canceling procurements of potentially excess material. We also wanted to determine the controls established by the Naval Supply Systems Command to monitor and evaluate the performance of the inventory control points.

During fiscal year 1983, ASO initiated 20,653 termination notices valued at about \$1.9 billion and SPCC initiated 24,429 termination notices valued at about \$800 million. At these locations we drew a sample, using stratified random sampling techniques, of termination notices generated in May 1983, which was the most current month at the start of our review. Our universe consisted of 2,651 ASO termination notices valued at about \$224 million and 1,632 SPCC termination notices valued at about \$69 million. We selected 100 sample items at ASO and 75 sample items at SPCC. All projected estimates were computed at the 95-percent level of statistical confidence.

We reviewed the computer termination notices for the 175 sample items, evaluated termination actions taken by inventory managers, and determined the actions taken by purchasing personnel to cancel excess quantities on purchase requests and contracts. At ASO, we also examined records to determine if inventory managers reviewed termination notices in our sample universe within established timeframes. At SPCC, similar records were not available on the entire sample universe, however, we were able to determine review timeframes in several specific cases.

We interviewed inventory managers and their supervisors to obtain reasons for their decisions. Although our review was primarily concerned with the termination notices and their review by inventory management personnel, we also interviewed purchasing personnel to determine their role in canceling procurements. In addition, we discussed monitoring and evaluation procedures with officials of the Naval Supply Systems Command.

Further details on our methodology are contained in enclosure I. Our review was made in accordance with generally accepted government auditing standards and was performed between June 1983 and October 1984.

#### CANCELLATION RATE IS VERY LOW

ASO and SPCC inventory managers approved for possible cancellation less than 2 percent of the excess material on order for our 175 sample items. Of the \$60.5 million of excess material in our sample, cancellations approved by inventory managers amounted to \$1,023,000 and were made on 39 items. Of this amount, \$429,000 (less than 1 percent) actually was canceled. Our review showed that inventory managers could have approved for cancellation an additional \$1.2 million on 62 other sample items if the review thresholds and protection levels had not existed or if the inventory managers had taken proper and timely action on the termination notices. The dollar amount represents the value of the excess material on order questioned by us for the 62 items.

Based on the sample results, we estimate that an additional \$24 million (\$13 million at ASO and \$11 million at SPCC) of excess material procurements could have been approved for cancellation in May 1983 if the weaknesses identified by us had not existed. This represents 8 percent of the value of the May 1983 termination notices.

#### REVIEW THRESHOLDS NOT BASED ON ASSESSMENT OF COSTS AND BENEFITS

The Uniform Inventory Control Point data system generates termination notices when the material on order exceeds the computed requirements by certain dollar value limitations. ASO generates termination notices on only those items that have excess material on order exceeding \$5,000. SPCC varies the limitation with the type of procurement. During our sample month the threshold limitation was \$2,500 for purchase requests, \$10,000 for purchase requests under solicitation, and \$25,000 for contracts. In November 1983 SPCC increased the threshold to \$10,000 for purchase requests and \$50,000 for contracts.

These dollar limitations greatly affect the value of excess material that can be considered for cancellation. To illustrate, if the revised SPCC threshold of \$10,000 and \$50,000 had been in effect during May 1983, over \$7 million (10 percent) of the excess on order material would not have been identified by the automated system for possible cancellation.

ASO and SPCC told us that the dollar thresholds were established to cover the administrative cost of processing termination actions and to reduce the workload of buyers and inventory managers. We found, however, that the dollar thresholds were subjectively set by ASO and SPCC management and were not based upon detailed studies or cost-benefit analyses comparing the cost of termination actions with the savings derived from canceling procurements. The cost of canceling some procurements, such as purchase requests not yet under solicitation, should be minimal. The cost to cancel excess material under contract would be affected by the contractor's delivery schedule and incurred costs.

#### PROTECTION LEVELS NOT NEEDED

In reviewing termination notices, ASO and SPCC inventory managers routinely compute a level of stock to be protected in arriving at the quantity to be terminated. The protection level is computed by adding additional months of demand to the requirements objective. The purpose of the protection level is to provide assurance against running out of stock.

Our review showed that the added protection levels are not needed because the basic requirements computation made by the two inventory control points includes a safety level which essentially accomplishes the same purpose. According to the Navy,

the safety level is intended to guard against out of stock conditions caused by unforeseen changes in usage and leadtime and is computed by applying predetermined factors to cover the risk of running out of stock.

At ASO, the added protection levels on 13 of our sample items resulted in \$196,000 of excess material on order not being considered for cancellation. For example, on May 2, 1983, a termination notice was generated for 811 excess rotor compressor blades (NSN-2840-00-906-7252) valued at \$12,773. However, when the inventory manager reviewed the notice he established an added protection level of 3,267 blades to the basic requirements objective of 4,902 blades. As a result, cancellation of the excess blades was not attempted.

TERMINATION NOTICES NOT REVIEWED  
IN A TIMELY OR PROPER MANNER

Although both ASO and SPCC have strict requirements for proper and timely review of termination notices, these requirements often are not being met. ASO requires that inventory managers review termination notices with values exceeding \$300,000 (\$100,000 prior to July 1983) within 10 days of receipt and review all other termination notices within 30 days. SPCC requires that inventory managers review all termination notices within 5 days of receipt. We could not identify the reasons the established review timeframes differed between the inventory control points.

At ASO we found that inventory managers kept the termination notices much longer than the established time requirements. They attributed the delays to heavy workload and higher priority matters. Of the 100 items in our ASO sample, 57 were overdue for review. Several of them had been in the hands of inventory managers for more than 60 days. Moreover, ASO records showed that 1,502 of the 2,651 items in our sample universe had been in the hands of inventory managers for more than 60 days without being reviewed.

For example, the inventory manager did not take any action on a January 3, 1983, termination notice which identified 137 excess test slugs (NSN-1305-00-148-9229) on a purchase request. Four months later, on May 2, 1983, a second termination notice identified 133 excess test slugs valued at \$13,300. The inventory manager stated that he did not approve the termination notice because deliveries were expected under a contract awarded on March 25, 1983. If the January termination notice had been promptly approved while the procurement was still under a purchase request in a preaward status the excess test slugs could have been canceled internally at little or no cost. Furthermore, the inventory manager's reason for not approving the May termination notice was unjustified because it is the purchasing division's responsibility to decide whether cancellation of a contract should be attempted.

At SPCC inventory managers have 5 days to reject termination notices. Notices not rejected within the 5 days are automatically approved by the Uniform Inventory Control Point system and forwarded to the purchasing division for possible cancellation. Because of the brief period allowed for review, inventory managers often reject termination notices initially to avoid automatic approval for cancellation and hold them for later review. Unlike ASO, however, SPCC did not maintain the records needed to precisely quantify the extent that this situation occurred or to determine the length of time before the inventory managers reviewed the termination notices. However, we were able to identify several cases where inventory managers rejected termination notices without proper or timely reviews.

On six sample items with excess material on order valued at \$55,202, SPCC inventory managers rejected the termination notices without actually evaluating the need for the excess material. On eight other sample items with excess material on order valued at \$377,000, the inventory managers decided not to initiate cancellation action without consulting with the program managers responsible for the purchases. However, they never did consult with the program managers and they still rejected the termination notices. At the end of September 1983, six of the eight items were in long supply (two or more years of supply beyond current needs) and had \$1.7 million of material that was excess to current requirements.

In another case an SPCC inventory manager rejected the termination notice for three chain and pawls (NSN-1020-00-051-5971) valued at \$46,348 on the assumption that it would be uneconomical to terminate the contract because deliveries were due within 6 months of the termination notice. After confirming the excess quantities on order, the inventory manager should have approved the termination notice and left it up to the purchasing division to decide whether it would be economical to attempt cancellation.

#### WAYS TO INCREASE CANCELLATIONS

The prior sections identified three problem areas--review thresholds, protection levels, and termination notice reviews--where improvements would increase the potential for cancellations. We believe that the need for the thresholds should be reevaluated because they preclude millions of dollars of excess material from being considered for cancellation and because they are not based on studies which compare the administrative cost of canceling procurements with the money to be saved by not purchasing unneeded material.

As for the added protection levels, safety levels included in the basic requirements computation system already provide reasonable protection from unforeseen increases in usage and leadtime. Therefore, the routine use of protection levels to retain excess material on order should be discontinued.

The termination notice review process has several ramifications which require consideration. Inventory managers need to review termination notices in a timely manner since it is much easier and less costly to cancel purchase requests in a preaward stage than it is to wait until the procurements are under contract. Also, inventory managers should determine the accuracy of the termination quantities, using the latest data available, and forward the approved quantities to the purchasing division for possible cancellation. Inventory managers should leave it up to the purchasing division to decide whether cancellation should be attempted.

Inventory managers must realize the importance of reviewing termination notices. ASO and SPCC officials told us that inventory managers are evaluated primarily on their performance in initiating procurements and maintaining adequate stock levels to avoid running out of stock. We believe that because of this performance criteria, inventory managers are inclined to take no action or delay cancellation action on material excesses as a protective measure to avoid running out of stock. One possible way to deal with this situation is to make the review of termination notices an additional factor in evaluating the performance of inventory managers.

Another reason for the ineffective review of termination notices is that inventory manager decisions are not being adequately monitored by higher level supervisors at either inventory control point. For example, evidence of supervisory review was lacking on 54 of the ASO sample items and 36 of the SPCC sample items.

Finally, we found that the Naval Supply Systems Command does not monitor the performance of the inventory control points in canceling procurements of unneeded material. ASO and SPCC do not maintain statistics on the value of unneeded material actually canceled. In view of the high volume of potentially excess material and the low rate of cancellations found in our tests, we believe that headquarters level monitoring efforts are needed.

#### RECOMMENDATIONS

We recommend that the Secretary of the Navy direct the Commander, Naval Supply Systems Command, to:

- Reconsider the reasonableness of the termination review threshold amounts. Base the threshold amounts on a comparison of the administrative cost of canceling procurements with the money to be saved by not purchasing unneeded material.
- Discontinue the routine use of added protection levels when making cancellation decisions.

- Require that inventory managers review termination notices in a timely and objective manner. Give consideration to making this requirement part of the inventory managers performance evaluation.
- Direct that supervisors regularly review inventory manager decisions on termination notices.
- Establish controls for monitoring and evaluating inventory control point performance in canceling procurements of unneeded material. Obtain data on the value of unneeded material actually canceled.

#### AGENCY COMMENTS AND OUR EVALUATION

On February 8, 1985, the Department of Defense (DOD) provided comments on a draft of this report. (See enclosure II.) Except for our recommendation on protection levels, DOD agreed with our recommendations and identified plans for implementing them. These plans include (1) completing a study of review thresholds by June 30, 1985, (2) implementing a mechanized system for identifying and following up on overdue termination notices by June 30, 1985, (3) making individual termination statistics a factor in evaluating inventory manager performance, (4) implementing procedures requiring supervisory review of termination acceptances and rejections above specified dollar thresholds by June 30, 1985, and (5) developing a comprehensive and effective termination performance measurement system by October 1, 1985.

DOD did not agree with our recommendation to discontinue the routine use of added protection levels when making cancellation decisions. It stated that the added protection level was intended to guard against a situation where an item's requirement would vacillate between a buy and a termination position from one requirement computation cycle to the next, if minor fluctuations in computation elements, such as the demand rate, occurred. In this case, the benefits of cancellation savings would be negated by reprocurement action, which loses valuable leadtime, and additional administrative, termination, and unit price costs.

We recognize that in some instances item requirements will fluctuate between a buy and termination position and it may be necessary to add a protection level to current requirements to deter termination action on all or a portion of the potentially excess material. Our concern is that the inventory control points do not consider the need for the protection levels on a case by case basis but instead routinely add protection levels to all items with potentially excess material. In many cases protection levels are not needed. For example, we followed up on the 13 ASO sample items which were not considered for cancellation because of the added protection levels. We found

B-217670

that, at September 30, 1983, four of these items still had stocks on hand and on order totaling \$171,000 that were excess to requirements and that it would take from 27 to 64 months to use the excess material. We continue to believe that the routine application of protection levels to all items should be discontinued and that inventory managers should apply, justify, and document their use on an individual item basis.

As you know, 31 U.S.C. §720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations no later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Chairmen of the above committees; the Chairmen, Senate and House Committees on Armed Services; the Secretary of Defense; and the Director, Office of Management and Budget.

Sincerely yours,

*for Bill W. Thurman*  
Frank C. Conahan  
Director

Enclosures - 2

Accession For	
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METHODOLOGY

This enclosure discusses our methodology for sampling and evaluating termination notices. To evaluate procedures for identifying and canceling procurements of potentially excess material, we drew a sample of termination notice generated in May 1983. At ASO and SPCC, we obtained computer tapes of termination notices generated in May 1983, which comprised the universe from which we drew a sample for detailed review. The universe consisted of 2,651 ASO termination notices valued at about \$224 million and 1,632 SPCC termination notices valued at about \$69 million.

Due to the size of the universe, the distribution of dollar values, and the audit time which would have been required for a complete review of all May 1983 notices, we drew a sample using stratified random sampling techniques. From a computerized random number generator, we selected 100 ASO items and 75 SPCC items for our sample, distributed across strata based on dollar values as follows:

<u>Strata</u>	<u>Dollar range</u>	<u>ASO</u>			
		<u>Universe</u>		<u>Sample</u>	
		<u>No. of</u> <u>items</u>	<u>Value</u>  (millions)	<u>No. of</u> <u>items</u>	<u>Value</u>  (millions)
1	Less than \$10,000	909	\$ 6.3	30	\$ 0.2
2	\$10,000 to \$100,000	1,447	44.3	35	1.3
3	\$100,000 to \$1,000,000	264	69.0	20	4.8
4	Greater than \$1,000,000	<u>31</u>	<u>104.4</u>	<u>15</u>	<u>50.8</u>
	Total	<u>2,651</u>	<u>\$224.0</u>	<u>100</u>	<u>\$57.1</u>

<u>SPCC</u>					
<u>Strata</u>	<u>Dollar range</u>	<u>Universe</u>		<u>Sample</u>	
		<u>No. of items</u>	<u>Value</u>	<u>No. of items</u>	<u>Value</u>
			(millions)		(millions)
1	Less than \$10,000	938	\$ 3.7	43	\$0.2
2	\$10,000 to \$100,000	576	15.6	26	0.7
3	Greater than \$100,000	<u>118</u>	<u>49.6</u>	<u>6</u>	<u>2.5</u>
	Total	<u>1,632</u>	<u>\$68.9</u>	<u>75</u>	<u>\$3.4</u>

From the sample, we determined which sampled items were approved by ASO and SPCC inventory managers for possible cancellation and which were actually canceled. We also reviewed termination notices which were not approved for cancellation to determine whether additional items could have been approved for cancellation, if review thresholds and protection levels had not existed or if the inventory managers had taken proper and timely action on the termination notices.

We estimated additional items that could have been approved for cancellation in May 1983 using stratified random sampling estimation techniques. In other words, the sample average for each stratum was multiplied by the universe size for each stratum, and the results summed for all strata. The estimates and their associated confidence intervals are shown below. Interval estimates were computed at the 95 percent level of statistical confidence. That is, we are 95 percent confident that the actual value of additional cancellations that could have been approved in May 1983 is between the lower and upper limits of the range shown.

	<u>Estimate</u>	<u>95-percent confidence interval</u>	
		<u>Lower limit</u>	<u>Upper limit</u>
	(millions)	(millions)	(millions)
ASO	\$13.1	\$4.56	\$21.59
SPCC	<u>11.4</u>	3.32	19.64
Total	<u>\$24.5</u>		

ENCLOSURE II

ENCLOSURE II



SR  
MANPOWER,  
INSTALLATIONS  
AND LOGISTICS

THE ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D C 20301-4000

8 FEB 1985

Mr. Frank C. Conahan  
Director, National Security and  
International Affairs Division  
General Accounting Office  
Washington, D.C. 20548

Dear Mr. Conahan:

This is in response to your draft report dated January 8, 1985, "The Navy Can Increase Cancellations of Procurements for Unneeded Material," GAO Code 943580, OSD Case #6670.

The report has been reviewed, and the Defense Department agrees that the potential exists for increasing cancellations of unneeded materiel. The Navy will take appropriate action to increase its cancellation rates and improve the review process for termination actions.

The Department disagrees, however, that potentially excess procurements of spares and repair parts were as high as \$2.7 billion in fiscal year 1983. This figure was derived by duplicating figures from weekly reports, thus overstating the problem. [See GAO note.]

The Department is working hard to minimize purchases of unnecessary materiel. Accurate portrayal of the situation is essential to improve both Congress's and the public's perception of the Defense Department.

Comments addressing each finding and recommendation are contained in the enclosure. The Department appreciates the opportunity to comment on the report.

Sincerely,

Jerry L. Calhoun  
Principal Deputy Assistant Secretary of Defense  
(Manpower, Installations & Logistics)

Enclosure  
As stated

GAO note: We agree that the \$2.7 billion in termination notices may include some duplications and, therefore, have deleted this number from our final report. It should be noted, however, that our random sample drawn from the nine computer runs made during May 1983 did not identify any duplicate termination notices for the same item.

GAO DRAFT REPORT - DATED JANUARY 8, 1985  
(GAO CODE NO. 943580) OSD CASE NO. 6670

"THE NAVY CAN INCREASE CANCELLATIONS OF PROCUREMENTS  
FOR UNNEEDED MATERIAL"

DEPARTMENT OF DEFENSE COMMENTS

\* \* \* \* \*

FINDINGS

FINDING A: Navy Procedures For Identifying And Cancelling Excess Material. GAO reported that the two Navy inventory control points--Aviation Supply Office (ASO) and Ships Parts Control Center (SPCC)--use the Uniform Inventory Control Point system to compute requirements for material needed to fill customer requisitions and meet other obligations. GAO further reported that changes in item usage, production leadtimes, repair cycles, as well as other factors, can reduce current requirements and thus cause material on hand and on order to become excess. GAO found that the automated system generates termination notices for all excess quantities on order, with dollar values above established limitations. GAO further found that these termination notices are then reviewed by the inventory managers for possible cancellation. The approved termination quantities are forwarded to the purchasing division, where the decision on whether cancellation should be attempted is actually made.  
[See pp. 1 and 2.]

DoD Response: Concur.

FINDING B: Cancellation Rate in Procurements of Excess Material Is Very Low. Using stratified random sampling techniques, the GAO reviewed 175 items, valued at \$60.5 million, which in May 1983, had been identified as potentially excess material. GAO found that the ASO and SPCC inventory managers approved only \$1,023,000 (or less than 2 percent) of the items in the sample for possible cancellation. GAO further found that of this amount, \$429,000 (or less than 1%) was actually canceled. Based on its sample, GAO concluded that if the review thresholds and protection levels had not existed, or if proper and timely action had been taken on the termination notices, an additional \$24 million (\$13 million at ASO and \$11 million at SPCC) of excess material procurements could have been approved for cancellation. Considering that the total potential excess procurements identified in fiscal year was \$2.7 billion, GAO concluded that the potential for additional reduction in unneeded procurements is significant. [See pp. 1, 3, and 4.]

DoD Response: Partially concur. The Department agrees that the potential exists for increasing cancellation rates of excess materiel. The Department cannot, however, agree that the number of items and dollar value of potential annual cancellations is as

GAO note: Page references have been changed to correspond to pages in the final report.

high as that suggested in the draft report and in the cover letter to Secretary Lehman. It appears GAO misinterpreted the termination recommendation reports. These reports are issued weekly to inventory managers from the Supply Demand Review process. They include numbers of items and the dollar value of recommended terminations at that point in time. The same item will appear in subsequent reports if action is not taken on the initial recommendation. Thus, the figures in the reports cannot be added to produce a cumulative annual number of items and associated dollar value of potential annual cancellations. The Department feels that the \$2.7 billion cited as potentially excess procurements at ASO and SPCC for fiscal year 1983 is overstated and therefore misleading. The report implies that similar excesses exist in other fiscal years, which is also misleading.

FINDING C: Review Thresholds Are Not Based On Assessing Costs and Benefits. GAO found that ASO generates termination notices only on those items that have excess material on order exceeding \$5000, while SPCC varies the limitation with the type of procurement. GAO reported that in November 1983, the SPCC increased its thresholds--for example, on contracts moving from \$25,000 to \$50,000. GAO concluded these high dollar limitations greatly affect the value of excess material that can be considered for cancellation. GAO also reported that ASO and SPCC criteria for dollar thresholds used to generate termination notices were estimated, based on the administrative cost of processing termination actions and to reduce the workload of buyers and inventory managers. GAO found, however, that the dollar threshold were subjectively set by ASO and SPCC management and were not based upon detailed studies or cost-benefit analysis comparing the cost of termination actions with the savings derived from canceling procurements. GAO concluded that the cost of canceling procurements not yet on order should be minimal, while the cost to cancel excess material already under contract would be affected by the contractor's delivery schedule and incurred costs. [See pp. 1 and 4.]

DoD Response: Concur.

FINDING D: Additional Protection Levels Are Not Needed. GAO found that both the ASO and SPCC inventory managers routinely compute a level of stock to be protected in arriving at the quantity of stock that should be canceled. GAO concluded that the added protection levels are not needed because the basic requirements computation made by ASO and SPCC already includes a safety level, which essentially accomplishes the same purpose. [See pp. 1, 4, and 5.]

DoD Response: Partially concur. The Department agrees that the inventory managers routinely compute a level of stock to be protected in arriving at a quantity of stock to be canceled. The Department disagrees, however, with the conclusion that added protection levels are not needed because the requirements

computation contains a safety level that accomplishes essentially the same purpose. Safety level, as defined in DoDI 4140.39, is "the quantity of materiel which is required to be on hand to permit continued operation in the event of minor interruption of normal replenishment or unpredictable fluctuation in demand. The safety level...is structured so as to minimize time-weighted, essentiality-weighted requisitions short for those demands treated as recurring." The added protection level is intended to guard against the situation where an item's requirement would vacillate between a buy and a termination position from one computation cycle to the next, if minor fluctuations in requirements computation elements (e.g., demand rate) occurred. The benefits of any savings from procurement cancellations in this case would be negated by having to reprocur the item as well as by incurring such additional costs as administrative costs, higher unit prices, and termination costs. In addition, subsequent reprocurement action loses valuable leadtime, which can have a negative impact on Defense readiness.

Different protection levels are applied to excess quantities depending upon whether the materiel is under negotiation or under contract. For procurements still under negotiation, additional protection provided is rarely beyond the amount that would normally be procured. This level consists of the greater of the economic order quantity or six months' usage. For procurements under contract, the level is the greater of the economic order quantity or two years' usage to reflect the higher costs involved in terminating after a contract has already been awarded.

FINDING E: Termination Notices Not Reviewed In A Timely Or Proper Manner. GAO found that although ASO and SPCC have strict requirements for proper and timely review of termination notices, these requirements are often not met. GAO reported that ASO is required to review terminations with values exceeding \$300,000 within 10 days of receipt and all others within 30 days. At SPCC, inventory managers are required to review all termination notices within 5 days of receipt. GAO concluded that inventory managers often retained the termination notices for periods of time greatly exceeding the established requirements and therefore did not take cancellation action in a timely manner. GAO also concluded that it could not identify the reasons why established review timeframes differed between ASO and SPCC. (Of the 100 items sampled at ASO, GAO found 57 were overdue for review. Because of inadequate records, GAO could not determine the length of time at SPCC before the inventory managers reviewed terminations notices.) [See pp. 1, 5, 6.]

DoD Response: Concur.

FINDING F: Inventory Managers Should Be Rated On The Termination Process. GAO found that ASO and SPCC inventory managers' performance evaluations are based primarily on their performance in initiating procurements and maintaining adequate stock levels. GAO concluded that because of these performance criteria,

inventory managers are not inclined to take action on material excesses, to avoid running out of material. GAO also concluded that one way to deal with this situation is to make the review of termination notices an additional factor in evaluating the performance of inventory managers. [See p. 7.]

DoD Response: Concur.

FINDING G: Cancellation Process Not Being Monitored By Top Management. GAO found that another reason for ineffective review of termination notices is that inventory manager decisions are not being adequately monitored by higher level supervisors at either ASO or SPCC. (GAO noted that supervisory reviews were lacking on 54 of the ASO sample items and 36 of the SPCC samples it reviewed.) GAO also found that the Naval Supply Systems Command does not monitor the performance of ASO or SPCC inventory control points in canceling procurements of unneeded material and that ASO and SPCC do not maintain statistics on the value of unneeded material actually canceled. GAO concluded that ineffective and limited top management and supervising oversight over the cancellation process contributes to the low level of cancellations. [See pp. 1 and 7.]

DoD Response: Concur.

#### RECOMMENDATIONS

RECOMMENDATION 1. GAO recommended that the Secretary of the Navy direct the Commander, Naval Supply Systems Command, to reconsider the reasonableness of the termination review threshold amounts. (As a part of this recommendation, GAO suggested that the threshold amounts should be based on a comparison of the administrative cost of canceling procurements with the money to be saved by not purchasing unneeded material.) [See p. 7.]

DoD Response: Concur. Naval Supply Systems Command will conduct a cost benefit analysis to determine threshold amounts that balance the administrative cost to the canceled procurements with the savings generated by these cancellations. The study will be completed by 30 June 1985, and the results will be used to establish cost effective termination review dollar thresholds.

RECOMMENDATION 2. GAO recommended that the Secretary of the Navy direct the Commander, Naval Supply Systems Command, to discontinue the routine use of added protection levels when making cancellation decisions. [See p. 7.]

DoD Response: Nonconcur. As stated in the DoD response to Finding D, it is the Department's position that added protection levels are required, are cost effective, and directly relate to Defense readiness.

RECOMMENDATION 3. GAO recommended that the Secretary of the Navy direct the Commander, Naval Supply Systems Command, to require that inventory managers review termination notices in a timely and objective manner. (As a part of this recommendation GAO suggested giving consideration to making this requirement part of the inventory managers' performance evaluation.) [See p. 8.]

DoD Response: Concur. Timely review of termination notices will be accomplished. Navy has recently implemented a mechanized system at ASO for identifying and following up on overdue termination recommendations. This system will promote timely and proper review. Within 30 days, Naval Supply Systems Command will direct SPCC to develop a similar system by June 30, 1985. Effective with the current employee performance evaluation period, individual inventory manager termination statistics will be a factor in evaluating inventory manager performance.

RECOMMENDATION 4. GAO recommended that the Secretary of the Navy direct the Commander, Naval Supply Systems Command, to direct that supervisors regularly review inventory manager decisions on termination notices. [See p. 8.]

DoD Response: Concur. Navy activities will be directed by the Commander, Naval Supply Systems Command, by June 30, 1985, to implement procedures that require supervisory review of all item manager termination recommendations consistent with current supervisory review requirements in the procurement process. This will require supervisory review of termination acceptances and rejections above specified dollar thresholds.

RECOMMENDATION 5. GAO recommended that the Secretary of the Navy direct the Commander, Naval Supply Systems Command, to establish controls for monitoring and evaluating inventory control point performance in canceling procurements of unneeded material. (In connection with this recommendation, GAO suggested the Navy obtain data on the value of unneeded material actually canceled.) [See p. 8.]

DoD Response: Concur. The current mechanized system identifies termination requests and those accepted by the inventory manager. These statistics will be included in a performance measurement system for all levels of management. Currently no system exists to measure actual termination results. Termination costs are difficult to measure because they are normally negotiated through the Administrative Contracting Officer whose resultant contract price reductions may not be readily identifiable to a termination request. An attempt will be made by the Naval Supply Systems Command, to identify termination results and combine them with termination recommendation statistics to develop a comprehensive and effective performance measurement system by October 1, 1985.

**END**

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