Audit Report

OFFICE OF THE INSPECTOR GENERAL

CONTROLS OVER WHOLESALE DRUG INVENTORIES AT THE DEFENSE LOGISTICS AGENCY

Report No. 93-131 June 30, 1993

Department of Defense

Acronyms

ARCOS	Automation of Reports and Consolidated Orders System
CFR	Code of Federal Regulations
CSA	Controlled Substances Act
DEA	Drug Enforcement Administration
DLA	Defense Logistics Agency
DLAM	Defense Logistics Agency Manual
DLAR	Defense Logistics Agency Regulation
DPSC	Defense Personnel Support Center
DRMO	Defense Reutilization and Marketing Office
DRMS	Defense Reutilization and Marketing System
DWASP	DLA Warehousing and Shipping Procedures
FSC	Federal Supply Class
GAO	General Accounting Office
ICP	Inventory Control Point
ME	Margin of Error
MRC	Material Release Confirmation
NDC	National Drug Code
SAMMS	Standard Automated Materiel Management System

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

June 30, 1993

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Controls Over Wholesale Drug Inventories at the Defense Logistics Agency (Report No. 93-131)

This report is provided for your review and comments. The report discusses the need for improved controls over the receipt, storage, and issue of controlled substances as defined in the Controlled Substances Act.

A draft of this report was issued for comment on November 6, 1992. A reply to the draft report was provided by the Defense Logistics Agency (DLA) on February 9, 1993. The DLA nonconcurred with the finding, six of the eight recommendations and the internal control weaknesses included in the report. The DLA partially concurred with Recommendations 1.a.(1). and 1.a.(2). These two recommendations are merged and renumbered 1.a. in this final report. For the reasons stated in the Management Comments and Audit Response section in Part II of the report, we believe the recommendations are still warranted. We added Recommendation 1.b. to correct automated information system errors which impact the accuracy of stock records for controlled substances. Recommendations originally numbered 1.b. and 1.c. were renumbered 1.c. and 1.d., respectively. We also added Recommendation 1.e. to focus attention on the need to document adjustments to controlled substance inventory records. It is requested that the DLA reconsider its position on the unresolved issues and provide additional comments in response to this final report. A table at the end of the finding identifies the unresolved issues and the specific requirements for your comments.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Recommendations are subject to resolution in accordance with DoD Directive 7650.3 in the event of nonconcurrence or failure to comment. Therefore, your reply to this final report is requested by September 3, 1993.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Harrell Spoons at (703) 692-2846 (DSN 222-2846) or Ms. Dianna Pearson at (703) 692-2851 (DSN 222-2851). The distribution of this report is listed in Appendix J.

Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 93-131 June 30, 1993
Project No. 1LA-0028

CONTROLS OVER WHOLESALE DRUG INVENTORIES AT THE DEFENSE LOGISTICS AGENCY

EXECUTIVE SUMMARY

Introduction. The Defense Personnel Support Center (DPSC) is registered to procure, warehouse, and distribute narcotic substances under the provisions of the Controlled Substances Act (CSA). DPSC maintains accountable records for controlled substances managed by the Defense Logistics Agency (DLA), and four DLA depots have physical custody of the controlled substances. The DPSC is the largest single distributor of controlled substances in the United States. In May 1991, DPSC managed a controlled substance inventory valued at about $5.7 million.

Objective. The overall objective was to evaluate controls over wholesale inventories of controlled substances that were managed by DLA. Specific objectives were to evaluate:

o controls over the receipt, storage, issue, and physical security of controlled substances;

o inventory procedures and transaction processing; and

o implementation of the Federal Managers' Financial Integrity Act as it pertains to the audit objectives.

Audit Results. Management of controlled substances needed to be improved. The CSA requires DPSC to account for each pill, dose, vial, etc., of controlled substances from receipt to final disposition with no exceptions. Thus, error rates that might be considered commendable when managing other commodities are unacceptable when managing controlled substances. DPSC's stock records for controlled substances were inaccurate and did not comply with Federal law; our inventory count and reconciliation of the May 1, 1991, inventory record of controlled substances, valued at $5.7 million, shows projected overages of $817,408 and shortages of $33,325; about $513,000 of unserviceable, controlled substances was dropped from accountable records before final disposition; and shipping losses of controlled substances valued at $54,540 were not investigated. The street value of these items, which are controlled to prevent their use for illegal and harmful purposes, could be many times the DPSC recorded value.

Internal Controls. We found material weaknesses in the internal controls over controlled substances. The controls we assessed are described in Part I of the report, and the finding provides details on the weaknesses.

Potential Benefits of Audit. No monetary benefits are associated with the recommendations in this report. However, implementation of the recommendations will strengthen controls over controlled substances and will help ensure compliance with applicable Federal laws (Appendix H).

Recommendations. We recommended the establishment and maintenance of accountable records in compliance with Federal law, improved inventory procedures, positive controls over unserviceable stocks, and investigation of losses of controlled substances. In this final report, two recommendations on inventory procedures were merged to avoid redundancy. Also, two new recommendations were added to correct automated information system errors, which impact the accuracy of stock records for controlled substances, and to focus management attention on the need for improved controls over controlled substance record adjustments.

Management Comments. The Defense Logistics Agency nonconcurred with the finding, six of eight recommendations and the internal control weaknesses. Management stated that the audit count of controlled substances was flawed; therefore, audit projections based on those data were unreliable. Management also stated that existing procedures and systems were adequate for managing controlled substances. Information is provided in the Audit Response section of the report that indicates that the recommendations are still warranted. Based on that information, the Defense Logistics Agency is requested to reconsider its position and provide additional comments on this final report by September 3, 1993.

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This report was prepared by the Readiness and Operational Support Directorate, Office of the Inspector General for Auditing, DoD. Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate (703) 614-6303 (DSN 224-6303).

Part I - Introduction

Background

The Controlled Substances Act (CSA), Title II of the Comprehensive Drug Abuse Prevention and Control Act of 1970, is the legal foundation of the Government's fight against abuse of drugs and other controlled substances. The CSA mandates controls over the importation, manufacture, distribution, possession, and use of the controlled substances defined in the legislation. The CSA places all substances that are regulated under existing Federal law into one of five schedules based on the substance's medical use, potential for abuse, and safety or dependence liability.

Schedule I substances have the highest potential for abuse and as of the time of the audit, have no accepted medical use. Schedule I substances are not stocked in DoD. Schedule II substances have a high potential for abuse, but they serve legitimate medical purposes and are stocked by DoD organizations under stringent security controls. Schedules III, IV, and V substances have less potential for abuse and are, therefore, subject to less stringent security procedures; however, accountability over all controlled substances must be maintained from manufacture or importation to final disposition.

The Deputy Under Secretary of Defense for Logistics establishes policy and provides oversight for DoD Components in executing physical inventory controls of the DoD supply system. The Director, Defense Logistics Agency (DLA), establishes policy and guidance and exercises supervision over the management of DLA-owned stock. The Defense Personnel Support Center (DPSC), a DLA field activity, procures and directs the distribution of controlled substances, and is registered with the Drug Enforcement Administration (DEA) as a distributor of controlled substances in compliance with the CSA. DPSC maintains the accounting records for wholesale, controlled substances managed by the DLA. The DLA depots at Mechanicsburg, Pennsylvania; Memphis, Tennessee; Tracy, California; and Ogden, Utah, are responsible for storage, physical security, and inventory management of controlled substances. The DLA depots have custodial responsibility for the stock in their possession.

DPSC is the largest single distributor of controlled substances in the United States. However, DPSC procures only about 55 percent of the controlled substances used in DoD because hospitals and medical activities are encouraged to shop for the best bargain, in terms of price and availability, from any authorized source. Furthermore, controlled substances with a shelf life of only 12 to 18 months usually are not stocked by DPSC and must be procured commercially. In May 1991, DPSC had an inventory of $5.7 million in controlled substances.

Objectives

The overall objective of the audit was to evaluate internal controls over the wholesale inventories of controlled substances managed by DLA. Specific audit

objectives were to evaluate the adequacy of controls over the receipt, issue, storage, and physical security of controlled substances, and compliance with general inventory procedures, including transaction processing, in preparation for financial statement audits of DLA stock fund accounts. The audit also evaluated implementation of the Federal Managers' Financial Integrity Act as it pertained to the audit objectives.

Scope

The audit included the wholesale inventories of controlled substances, as defined in the CSA, that are managed by DLA. Policies and procedures for receiving, storing, and shipping controlled substances were reviewed. Actual practices used for receiving, storing, and shipping controlled substances were observed. Transaction records were examined, and inquiries were made to the police departments responsible for protective and investigative services at the DLA depots.

We selected a stratified random sample of controlled substance line items from a May 1991 computer tape containing inventory records, and we conducted physical counts at the four DLA depots that stored the items. We compared our counted inventory quantities to recorded quantities as of the date of the counts and reviewed transaction history data to resolve discrepancies. Technical assistance on sample selection was provided by the Quantitative Methods Division of the IG, DoD. Details on the sampling plan are in Appendix A.

The audit was made from March 1991 through April 1992 at the activities listed in Appendix I. This economy and efficiency audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary.

Internal Controls

The audit evaluated internal controls over the receipt, issue, storage, and physical security of controlled substances in wholesale drug inventories at the four DLA activities authorized to store controlled substances. The audit included written policies, procedures, and practices observed in handling and accounting for controlled substances. The audit identified material internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Specifically, required inventories were not conducted, accounting records were inaccurate, and stock quantities were unknown. Furthermore, unserviceable, controlled substances were removed from accounting records before final disposition, and missing shipments of controlled substances, with individual item values of less than $50, were not researched and resolved. Details are provided in Part II of this report.

The recommendations in this report, if implemented, will correct the weaknesses. We did not identify any monetary benefits from implementing the recommendations. A copy of this report will be provided to the senior official responsible for internal controls within DLA.

Prior Audits and Other Reviews

General Accounting Office (GAO) Report No. NSIAD-88-39 (Office of the Secretary of Defense Case No. 7402), "Inventory Management: Defense Logistics Agency Inventory Accuracy Problems," December 24, 1987, states that the DLA Inventory Control Effectiveness reports need to be more informative to be used effectively by DoD and that inventory accuracy records need to consider record adjustments valued under $800. Furthermore, a record accuracy rate of only about 63 percent was reported for items requiring special storage in vaults. Additionally, 23 of 48 research reports, prepared by the supply centers for fiscal years 1985 and 1986 to identify causes for adjustments, were not available at the depots; thus, corrective actions could not be taken. Also, prescription and nonprescription drugs and medicines were stored in a warehouse with unrestricted access.

Report No. NSIAD 88-39 recommended that the Secretary of Defense change policy regarding inventory effectiveness reporting; that the Director, DLA, require statistical sampling of items by commodity type; that accuracy indicators be collectively analyzed to identify areas for further analysis; that reassessment of the causative research criteria be researched annually; and that centers and depots establish controls for the proper distribution of quarterly causative research reports. The report also recommended that the Director, DLA, require the Mechanicsburg depot to correct known security problems. DoD concurred with GAO's recommendations regarding statistical sampling, follow-up corrective action on causative research reports, and the need for improved physical security at the Mechanicsburg depot.

Part II - Finding and Recommendations

Management of Controlled Substances

Management of wholesale stocks of controlled substances within the DLA needed improvement. Stock records were inaccurate; unserviceable, controlled substances were dropped from accounting records before final disposition; some losses of controlled substances on in-transit shipments had not been investigated; and separate accounting records had not been established for controlled substances. This condition occurred because management at all levels did not ensure compliance with the procedures that had been established and the DLA and DPSC had not fully implemented the procedures required by the CSA for managing controlled substances. Our inventory count and reconciliation of the May 1, 1991, inventory of controlled substances, valued at $5.7 million, shows projected overages of $817,408 and shortages of $33,325. Also, the disposition of unserviceable, controlled substances valued at $513,046 was not documented and shipping losses valued at $54,540 were not investigated.

Stock Records

We selected a sample of controlled substances and conducted physical counts at the four DLA depots that store these items. We compared physical count quantities to on-hand record balances to determine the accuracy of stock records for controlled substances.

The audit disclosed variances between the actual quantities on hand and the DPSC recorded quantities for 74 of the 139 line items in our sample. Details on the inventory results for the line items that had variances and the results of our efforts to reconcile the variances are shown in Appendix B. There were no inventory variances at Ogden, Utah. Based on the sample results, we estimated that DPSC's accountable records for controlled substances reflect an estimated $817,408 in inventory overages and an estimated $33,325 in inventory shortages. Details on the statistical projections are shown in Appendix C.

Quarterly inventories of controlled substances were not made as required. DLA Regulation 4145.11 (DLAR 4145.11), "Safeguarding of DLA Sensitive Inventory Items, Controlled Substances, and Pilferable Items of Supply," February 1, 1990, requires a 100-percent closed, quarterly inventory of all drug abuse and sensitive items, including narcotics. Furthermore, DLAR 4145.11 states that all inventory discrepancies are subject to research and that unresolved discrepancies will be supported by a Report of Survey.

DLA depots had not conducted quarterly inventories on 53 of the 139 line items in our sample. DLA Manual (DLAM) 4140.2, "Supply Operations Manual," March 5, 1984, requires the DPSC to direct the depots to perform quarterly inventories. However, DPSC had not directed inventories for the controlled substances; therefore, discrepancies were not detected in a timely manner.

We researched transaction histories for the 74 line items to determine the reasons for the variances. We found that both DPSC and the DLA depots had made erroneous and undocumented adjustments to the accounting records for 27 line items. We found the erroneous adjustments by reviewing transaction histories. We found the undocumented adjustments because we visted one DLA depot twice and were able to track adjustments DPSC made to the record. There were 10 line items that had erroneous adjustments, including record adjustments, for which there was no supporting documentation. Details on the adjustments without documentation are summarized in Appendix D.

Discrepancies on another 24 line items were attributed to system errors. Transactions had been processed on DPSC records, but not on depot records, and system failures occurred, resulting in a loss of historical data. For example, on September 6, 1991, the automated information system processed a requisition for 45 units of 1 line item on the DPSC record, but the automated information system had not processed the requisition on the DLA depot record as of October 28, 1991. DLA officials acknowledged that errors do occur on the automated information systems, but could offer no explanation for system failures that caused the loss of historical transaction data.

Even though research of transaction histories identified the errors that caused the variances for 51 line items, the auditors considered the variance of only 1 of the 74 line items researched resolved. The variances for the remaining 73 line items were considered unresolved because DPSC could not explain why the errors occurred. Also, according to a DPSC variance report, 10 discrepancies that were found during the audit count of the sample line items in October 1991 were not reported to DPSC until February 1992 and March 1992, a delay of up to 5 months. Additional details are provided in Appendix E.

Unserviceable Stocks

DPSC did not maintain accountability over unserviceable, controlled substances until final disposition. Title 21, CFR, part 1304, requires each registrant authorized to distribute controlled substances to keep detailed records of all stock from receipt through destruction or other disposition. DLAR 4145.11 requires that disposal of controlled substances that are unfit for use due to expired shelf life or damages be accomplished in accordance with all Federal, State, and local regulations. However, DLAM 4140.2, "Supply Operations Manual," March 5, 1984, excludes stock in condition code H (unserviceable stock) from quarterly inventories.

DLA depots are responsible for unserviceable items that are awaiting disposal action. When a controlled substance has been determined to be unserviceable, DPSC generates a Disposal Release Order authorizing DLA depots to dispose of the unserviceable stock. The condemned materiel is then reported to the depot's servicing Defense Reutilization and Marketing Office (DRMO) for destruction. Unserviceable stocks are dropped from DPSC's accountable records on the date

the DRMO acknowledges acceptance of the condemned materiel. However, because of secure storage requirements, unserviceable stock may not be physically removed from DLA depots when the materiel is dropped from the DPSC accounting record. The physical movement of controlled substances for destruction is typically accomplished when quantities of unserviceable stock make the procedure economically or operationally feasible. When destruction is completed, DLA depots are to inform DPSC.

DPSC did not account for controlled substances once the items had been designated for destruction. Also, DLA depots did not inventory the stock because of DLA policy that excludes unserviceable stocks from inventory, although the materiel remained in storage at DLA depots. With the absence of record data pertaining to the identification of the condemned stock, both DPSC and DLA depots lost accountability over unserviceable stock. As a result, unserviceable, controlled substances, valued at $513,046, were removed from DPSC accounting records, but neither the substances nor documentation on the destruction of the items could be located at the responsible DLA depots. Appendix F shows controlled substances that DPSC records indicate had been designated for destruction, but for which neither the stock nor documentary evidence of destruction could be located at the responsible DLA depots. As a result, unserviceable stock could be susceptible to misappropriation.

Shipping Losses

DPSC did not research and resolve all customer complaints concerning items missing from DLA depot shipments of controlled substances. Title 21, CFR, part 1301, requires that the registrant be responsible for providing adequate security to guard against the diversion of controlled substances while they are being handled by transportation carriers. Also, the CFR requires that the registrant be accountable for reporting in-transit losses of controlled substances.

DPSC was not adequately researching missing controlled substances from DLA depot shipments that had been sent to customers. We reviewed actions taken on 113 complaints involving missing shipments of controlled substances (see Appendix G). On 45 of those complaints on shipments with a total value of about $21,000, DPSC gave credits to customers without determining the disposition of the missing controlled substances. For 19 complaints on shipments with a value of about $27,000, DPSC determined that the carriers were liable for the lost shipments, but did not determine what happened to the missing controlled substances. For another 44 complaints on shipments totaling $1,200, DPSC determined that the dollar value of the alleged loss did not warrant research because the dollar value of the shipment was $50 or less.

Although the wholesale dollar value of the missing shipments was about $50,000, the street value could be far greater, depending on the substance and the area in which it might be illegally marketed. For example, a customer did not receive a controlled substance shipment containing 120 items. The cost of the substances shipped was about $1,225. However, the estimated street value

of this shipment could be as much as $9,000, depending on the geographical area and the market for the substances. Another controlled substance shipment containing 576 items with a cost of $1,555 had an estimated street value of $3,500. Nonetheless, based on the records DPSC provided, none of the missing items was reported to DEA. Furthermore, DPSC's handling of the complaints was not in compliance with the CSA, which requires that all shortages of controlled substances be researched.

During the audit, DPSC officials told auditors that for a relatively short time, DPSC did give credit to customers without determining the disposition of missing controlled substances. Personnel shortages were cited as the reason. DPSC corrected this deficiency in October 1991. Because of the potential harm that could result from the loss of a shipment of controlled substances, we believe that investigation of controlled substance shipping discrepancies should be given priority over other shipping losses during periods of staff shortages.

Controlled Substance Act Requirements

The manner in which DPSC maintained records of controlled substances did not comply with Federal law. Title 21, Code of Federal Regulations (CFR), part 1304, requires that records for Schedule I and Schedule II items be kept separate from all other records of the registrant and that records for Schedules III through V be kept separately or be readily retrievable from the registrant's ordinary business records. The term readily retrievable means that the records can be segregated from all other records in a reasonable time or can be visually identifiable among other records. Also, registrants are required to keep records of controlled substances available for inspection by the DEA for at least 2 years.

The audit showed that DPSC did not establish or maintain separate records for Schedule II controlled substances. Furthermore, records for Schedules III, IV, and V controlled substances were not readily retrievable. Records of controlled substances managed by DPSC were combined with other commodities in Federal Supply Class (FSC) 6505.

In addition to controlled substances, FSC 6505 included nonnarcotic medical substances, medical instruments and devices, and other medical paraphernalia. Controlled substances could be distinguished from other commodities in FSC 6505 only by referring to the National Stock Number. The DPSC was unable to provide the auditors a separate list of controlled substances; instead, a computer-generated record of FSC 6505 commodities with security codes "R" or "Q" that had to be manually searched to identify the controlled substances subject to the CSA.

DPSC did not report controlled substance transactions to the DEA. Title 21, CFR, part 1304, requires registered distributors to submit reports monthly to DEA, identifying the form (pill, dose, capsule, etc.), strength, and trade name, if any, of the product containing each controlled substance listed in

Schedules I and II. A monthly report to DEA also was required on each narcotic controlled substance listed in Schedule III. We found no evidence of the reports, and DPSC personnel stated that no reports had been submitted to DEA. While the audit was in progress, neither DPSC nor Headquarters, DEA could provide documentation to show that DPSC had been granted relief from the reporting requirements. However, after the draft of this report was issued DPSC provided a memorandum dated January 10, 1978, internal to the DEA, that stated DPSC was exempt from reporting under the Automation of Reports and Consolidated Orders System (ARCOS) because DPSC records did not identify each controlled substance by the National Drug Code number that is required for reporting purposes. Thus, because of incompatible records the single largest distributor of controlled substances in the nation is exempt from submitting the reports that are a key element of the closed system of distribution mandated by the CSA.

Internal Management Control Program

DLA had not identified controlled substances that DPSC stores at the DLA depots as an assessable unit under the DLA internal management control program. Additionally, DLA did not require the depots to address controlled substances as an assessable unit. According to DLA officials, the DLA depots were allowed to evaluate their own organizations and identify assessable units. However, a lack of specific guidance from DLA allowed the DLA depots to inconsistently identify assessable units. One depot identified the medical branch as an assessable unit, but none of the DLA depots identified controlled substances as a separate assessable unit.

Based on our sample results, we found overages of controlled substances that are not on accounting records. Inventory overages of controlled substances could be vulnerable to misappropriation. If DLA depots do not assess controlled substances for inherent risk, potential material control weaknesses could continue and result in undetected misappropriation of the substances.

Conclusions

Controls over wholesale stocks of controlled substances in DLA do not comply with Federal law and are not sufficient to ensure prompt detection of loss or misappropriation. DPSC did not maintain separate records for controlled substances as required by the CSA, and the accuracy of records detailing transactions is questionable. DPSC dropped unserviceable, controlled substances from accountable records before final disposition, and low-value shipping losses were not investigated, even though the street value of the controlled substances may be much higher in illegal transactions.

DLA and DPSC should establish and implement procedures to ensure compliance with the CSA. The control procedures, record keeping, and reporting requirements provide minimum safeguards against diversion and misuse of controlled substances.

Recommendations for Corrective Actions

1. We recommend that the Director, Defense Logistics Agency:

a. Amend Defense Logistics Agency Manual 4140.2 to require that Defense Logistics Agency depots inventory all controlled substances quarterly and report the results to the Defense Personnel Support Center.

b. Direct the Defense Personnel Support Center to determine the reasons for the automated information system errors impacting the accuracy of stock records for controlled substances and execute the changes that will resolve the errors.

c. Direct Defense Logistics Agency depots to account for controlled substances that are awaiting destruction and to provide documentation of all destruction actions to the Defense Personnel Support Center and to the Drug Enforcement Administration.

d. Require each organization involved in managing controlled substances to identify those substances as a separate assessable unit under the internal management control program and to conduct the requisite risk assessments.

e. Direct the Defense Personnel Support Center and the Defense Logistics Agency depots to establish controls which will prevent adjustments to the controlled substance balances that are not supported by appropriate documentation.

2. We recommend that the Commander, Defense Personnel Support Center:

a. Establish and maintain separate accountable records for Schedule II controlled substances.

b. Establish and maintain accountable records that are readily retrievable for controlled substances in Schedules III, IV, and V.

c. Maintain accountable records for all controlled substances from receipt until final disposition.

d. Research all discrepancies on shipments of controlled substances, regardless of the dollar value of the discrepancy, and report losses to the Drug Enforcement Administration.

Management Comments and Audit Response

The Defense Logistics Agency took exception to the report's introduction, finding, and recommendations. The full text of management's comments is in Part IV of this report. We have included management's comments on various statements in the report in addition to its comments on the finding and recommendations.

DLA Comment. The report reflects an apparent misunderstanding by the auditors on the differing missions of inventory control points (ICPs) and DLA depots.

Audit Response. DPSC is the ICP for controlled substances. As such, DPSC is responsible for warehousing controlled substances and performs that responsibility by directing controlled substances to DLA depots for storage. Although the DLA depots have physical custody, DPSC retains control over controlled substances.

DLA Comment. The total dollar value of DPSC's inventory was $511 million. DPSC did not spend $511 million to procure controlled substances.

Audit Response. Reference to the $511 million has been deleted from the final report.

DLA Comment. Only one of the record inventory quantities reported in the audit could be located in the DPSC accountable record transaction history files, and there is no indication that the audit considered the numerous supply transactions that occurred while the items were being inventoried.

Audit Response. DPSC provided the inventory record quantities that were compared to the physical count quantities. DPSC personnel instructed the audit staff in the proper research procedures and jointly researched many of the reported inventory discrepancies with the auditors. The auditors kept records of the dates and times that the physical counts were made because DPSC did not initiate procedures to automatically track (freeze) the items counted as agreed. The information on dates and times permitted needed adjustments to be made for precount and postcount transactions.

DLA Comment. The statement that required inventories were not conducted needs to be qualified to put the report in a proper perspective. DPSC directed the required inventories in 99.9 percent of the cases, and the depots completed about 94 percent of the inventories.

Audit Response. DLA's statement that 94 percent of the inventories were completed may apply to inventories of all DPSC-owned stock. Our comments regarding inventories apply only to the controlled substance line items in the audit sample. We examined DPSC and depot transaction histories, depot inventory records and manual inventory records for the controlled substances

in the sample. Based on our review of those records and interviews with responsible personnel, we determined that the required quarterly inventory had not been done for 53 of the 74 line items with inventory variances in the audit sample.

DLA Comment. The report indicates a misunderstanding of the disposal process. The Defense Reutilization and Marketing Office (DRMO) becomes the accountable office for the material (unserviceable controlled substances); therefore, the DRMO is responsible for compliance with DLAR 4145.11 and title 21, CFR.

Audit Response. Title 21, CFR 1304.23, makes the registrant responsible for controlled substances from receipt until final disposition. The DRMO is not a registrant with the DEA under title 21, CFR. DLAR 4145.11 requires DLA depots that have physical custody of controlled substances to report the intent to destroy controlled substances to the appropriate DEA division office. Furthermore, DLAR 4145.11 requires that, before ultimate disposal, the DLA depot consult with the local DRMO to ensure that the disposal of controlled substances is done in accordance with DoD Manual 4160.21-M. In a February 24, 1993, letter, the Defense Reutilization and Marketing System (DRMS) advised DLA Headquarters that:

> DoD 4160.21-M emphatically states:
>
> (1) DRMOs are not to physically accept controlled substances, regardless of resources or technical expertise.
>
> (2) The generator [DPSC] is responsible for the destruction of controlled substances.
>
> (3) The DRMO shall accept accountability only if providing assistance to sell a controlled substance. The DMRS has no record of a DRMO having done this.

We agree that there is a misunderstanding about the accountability of controlled substances that have been identified for disposal, but the misunderstanding is between DLA Headquarters and the DRMS.

DLA Comment. The Standard Automated Material Management System (SAMMS) automatically generates a mandatory research document whenever a shipment of controlled substances is missing, regardless of dollar value.

Audit Response. Title 21, CFR 1301.74(c), makes the supplier responsible for investigating and reporting in-transit losses of controlled substances upon discovery of such theft or loss. DPSC did not research all reports of discrepancies on shipments made to customers. In some cases, DPSC issued the customers credit without determining the reason for the loss. In other cases, DPSC instructed the customer to file a claim against the carrier without determining the reason for the loss.

DLA Comment. The report cites two General Accounting Office reports that are 5 and 8 years old, respectively. DLA saw no need to reference or quote old reports.

Audit Response. We routinely reference prior audit reports that are pertinent to the objectives and scope of a current audit. However, reports more than 5 years old are usually excluded. We have deleted the reference to the 8-year-old report.

DLA Comment. The basis of the alleged overages and shortages involves a series of comparisons made between actual on-hand balances at the depot versus balances at the DPSC. The draft extrapolates the apparent imbalances from the sample to the universe of controlled substances. Given the lack of establishment of control over in-float transactions, the extrapolations are questionable at best.

Audit Response. DPSC advised the auditors that the proper freezes were established for the controlled substances in the audit sample. However, because of conflicting reports about the freezes, line items with inventory variances were extensively documented during the audit and transaction histories for the 2 years that records are maintained were researched. As a result, the audit determined the reasons for discrepancies on 47 line items. Even with the assistance of DPSC researchers, the reasons for the discrepancies on 27 line items could not be determined. However, for 13 of those line items with unresolved discrepancies, DPSC and auditors were in agreement with respect to the size and nature of the variance. We believe that the audit results are factual and that projections based on those results are statistically valid.

DLA Comment. Controlled substance records and transactions are recorded and identified within SAMMS, and they are readily retrievable in accordance with title 21, CFR. Those records can be extracted and hard copies can be produced within a maximum 24-hour time frame for all controlled items.

Audit Response. When the auditors requested a list of controlled substances, the DPSC provided only a list of all Federal Supply Class (FSC) 6505 material. Manual review of the 863 page list was required to identify controlled substances among the other items in that FSC. Title 21, CFR 1304.04(f)(1), requires that records of Schedule II controlled substances be amintained separately from the records of controlled substances in Schedules III, IV, and V. DPSC's records of Schedule II controlled substances were comingled with other FSC 6505 items.

DLA Comment. DPSC reported controlled substance procurements to the DEA as required. DPSC is exempt from the reporting requirements contained in title 21, CFR. The DEA has cognizance over auditing controlled substances, and audits DPSC every 3 years. The DEA last audited DPSC in March 1990, at which time it reviewed procedures for submitting the DEA Form 222, which is required for each distribution of a Schedule II controlled substance. DEA did not cite the DPSC for not submitting formal quarterly reports or for any of the accounting concerns stated in this audit report.

Audit Response. DPSC does not report procurements of controlled substances to DEA. Instead, the vendors that sell controlled substances report DPSC's purchases to the DEA. Title 21, CFR 1304.37(a), requires registrants to use the National Drug Code (NDC) number assigned to the product under the National Drug Code System of the Food and Drug Administration to report transactions in controlled substances to the DEA. NDC numbers are basic to the ARCOS reporting system that supports periodic transaction reporting by registrants. On January 10, 1978, the DEA granted the DPSC an exemption from ARCOS reporting because the DPSC was unable to identify NDC numbers. We believe that during the ensuing 15 years, the DPSC should have developed a conforming record system for controlled substances.

The DEA does not audit the DPSC but does inspect it. However, the inspection is limited to the records available at the DPSC. The DEA does not inspect the depots that store controlled substances; therefore, facilities and procedures for receiving, storing, shipping, and exercising physical custody of controlled substances are excluded from DEA oversight. The DEA officials with whom we spoke expressed frustration because the DEA has been unable to enforce DPSC's compliance with the CSA. However, DEA's inability to enforce DPSC compliance with the provisions of title 21 is not a valid justification for continued noncompliance.

DLA Comment. Quarterly inventories of controlled substances are conducted as required. A review of DPSC's inventory scheduling and completion report for FY 1991 and FY 1992 showed that 99.9 percent of all Schedule II controlled substances were *scheduled* by the DPSC to be inventoried each quarter. DLA cited conditions that could authorize cancellation of scheduled inventories and systems that provide visibility over canceled inventories.

Audit Response. The audit showed that the system that provides visibility over canceled inventories does not always function as intended. The audit found no evidence that quarterly inventories for 53 of the sampled controlled substance line items had been made.

DLA Comment. The alleged imbalances occurred because the auditors chose to conduct warehouse counts in lieu of establishing formal inventories.

Audit Response. As discussed previously, before the start of the audit counts, the inventory plan was coordinated with the DPSC. The auditors provided the DPSC the identity of each line item of controlled substances to be inventoried at each of the DLA depots that store controlled substances. After the audit count started at Mechanicsburg, the DPSC told the auditors that it had failed to freeze the sample items. The auditors immediately suspended the count. The DPSC then provided auditors with beginning and ending dates for the audit count at all sites. All audit counts were made in accordance with the schedule provided by the DPSC; however, because of uncertainties concerning DPSC's actions with respect to the inventory freeze, the auditors documented the exact date and time of all counts. Therefore, the auditors were able to identify in-float transactions when researching variances.

DLA Comment. The report states that variances occurred because of transactions that had been processed on the DPSC record but not on the depot records because the substances had not been shipped. Those transactions are classical examples of in-float transactions and invalidate the auditors' sample results and projection to the controlled substance universe.

Audit Response. The audit distinguishes between in-float transactions and errors. We identified discrepancies by comparing the DPSC and DLA depot records over a 2-year period. The research revealed transactions posted to DPSC's records without a corresponding transaction posted to the DLA depot records. The situation described by DLA would be an in-float transaction if both the DPSC and the DLA depot had posted their records, but the stock had not yet been shipped, at the time of the audit. Conversely, an error occurs if the DPSC record subtracts the quantity, but the corresponding quantity is never subtracted from the depot's records.

The DPSC supported the audit with the resources needed to reconcile the variances including the Mandatory Research Report (289 Report) that the DPSC uses to research variances between the depot and the DPSC balances. Of the 74 sample line items with variances, 21 were listed on the 289 Report. The reported variances were the same as the audit variances for 16 of the 21 items. We believe that all 74 line items would have been listed on the 289 Report if quarterly inventories had been conducted as required.

DLA Comment. The report states that 73 of 74 line items reflected unresolved variances. The alleged variances occurred because formal inventories were not scheduled to control in-float transactions. It is true that, occasionally, a transaction could appear on one record and not the other, but the SAMMS and the DWASP (DLA Warehousing and Shipping Procedures) have an automated interface mechanism to catch those types of system mismatches. Each system generates research documents that are used to correct incompatibilities between the records.

Audit Response. Management's comments confirmed that the reported record mismatches do occur between SAMMS and DWASP. The DPSC personnel who assisted the auditors in attempting to determine the reasons for the unresolved imbalances on 27 line items had access to all of DLA's management systems. Nonetheless, DPSC personnel could not determine the reasons for those imbalances.

DLA Comment. Unserviceable stocks are still controlled substances. When a Disposal Release Order is received, the depot must hold the materiel until the DRMO can arrange for proper disposal. Although the material is dropped from the DPSC records and the depot's inventory, it is properly picked up on DRMO's records. Any subsequent inventories should be conducted by the DRMO. DLA depots should not inventory stock no longer officially on their inventories.

Audit Response. Management's comments confirm that DPSC drops accountability over controlled substances identified for disposal. Title 21, CFR 1304.23, requires the DPSC to maintain records of controlled substances from

receipt to final disposition. However, the DPSC drops unserviceable, controlled substances from its records and from depot inventories. The DRMO is prohibited from accepting accountability for controlled substances. The audit found no documentation to verify that the quantities of controlled substances dropped from accountable records as unserviceable were destroyed. Therefore, when accountability is abandoned, unserviceable stocks of controlled substances may be vulnerable to misappropriation.

DLA Comment. All controlled substances shipped from DLA depots are shipped via signature service (pick-up and delivery must be recorded). In many cases, customers have complained about missing items for which the depots discover the customer has signed for as received.

Audit Response. Title 21, CFR 1301.74, makes the registrant, or the DPSC, responsible for reporting in-transit losses. Furthermore, in event of theft or loss, the registrant is required to submit DEA Form 106 whether or not the controlled substances are subsequently recovered. The audit showed that the DPSC had issued customer credit without determining the reasons for the in-transit loss and had directed customers to research in-transit losses through their own transportation channels.

DLA Position on Recommendation 1.a. DLA partially concurred, stating that DLAM 4140.2 requires the depots to inventory controlled substances quarterly and report the results to the DPSC. DLA considered this action complete.

However, DLA went on to state that it recently implemented a system change that will prevent DLA depots from excluding certain controlled substances in their inventories and from automatically cancelling inventories due to the receipt of a Disposal Release Order. DLA will initiate action to apply this logic to all inventories involving controlled items. DLA acknowledged that the condition represented an internal control weakness, but stated that the weakness was not material.

Audit Response. We consider DLA's comments partially responsive. The system change to require quarterly inventories of controlled substances regardless of condition code will satisfy the intent of the recommendation; however, we consider the loss of accountability over unserviceable, controlled substances to be a material internal control weakness. We ask that management reconsider its position on the weakness in response to the final report.

Recommendation 1.b. This is a new recommendation not included in the draft report.

DLA Position on Recommendation 1.c. (1.b. in the draft report). DLA nonconcurred, stating that the DLA depots have been directed to account for controlled substances that are awaiting destruction. DLA also stated that applicable documentation should be maintained by the DRMO and the DEA, not the DPSC. Furthermore, at the point of controlled substance destruction, the DRMO is accountable, not the DPSC.

Audit Response. We consider DLA's comments nonresponsive. The audit showed that, in accordance with DLA procedures, controlled substances identified as unserviceable were dropped from the DPSC accountable records and from DLA depot inventories. At that point, accountability for unserviceable, controlled substances ceased to exist. Title 21, CFR 1304.23, makes the registrant (the DPSC) responsible for controlled substances from receipt to final disposition. The DRMOs are not registered with DEA, thus accountability may not be delegated to them. Furthermore, DLA stated that accountability for unserviceable material rests with the DRMO and the DEA. The DRMO is not permitted to accept accountability for controlled substances, unless the items are to be sold (an event that has never occurred), and the DEA is not accountable for DoD-owned commodities.

DLA Position on Recommendation 1.d. (1.c. in the draft report). DLA nonconcurred, stating that existing systems provide the necessary controls required to effectively manage and accurately account for controlled substances. Furthermore, this position is supported by the DEA as evidenced by the latter's March 1990 audit.

Audit Response. We consider DLA's comments nonresponsive. Despite the detailed and stringent controls mandated by title 21, CFR 1300, for managing controlled substances, the DPSC managed controlled substances in the same manner, using the same systems, as for any other commodity with Physical Security Code Q or R. DPSC is required to account for each pill, dose, vial, etc., from receipt to final disposition with no exceptions. Thus, error rates that might be considered commendable when managing other commodities are unacceptable when managing controlled substances. The conditions noted in this report, particularly commingling accountable records of Schedule II controlled substances with other FSC 6505 records; abandoning accountability for unserviceable, controlled substances; and not investigating every in-transit loss of controlled substances are material internal control weaknesses. Identifying management of controlled substances as a separate assessable unit under the internal management control program is necessary to ensure appropriate management attention to the risks inherent in the receipt, storage, and distribution of narcotic controlled substances.

Recommendation 1.e. This is a new recommendation not included in the draft report.

DLA Position on Recommendation 2.a. DLA nonconcurred, stating that controlled substance accountable records are maintained in the SAMMS and are readily retrievable for Schedule II items.

Audit Response. We consider DLA's comment nonresponsive. In addressing the record-keeping requirements of registered distributors, title 21, CFR 1304.04(f)(1), states that "Inventories and records of controlled substances listed in Schedules I and II shall be maintained separately from all of the records of the registrant . . . ." The DPSC does not maintain separate records for Schedule II substances; therefore, the records do not comply with the CSA.

DLA Position on Recommendation 2.b. DLA nonconcurred, stating that controlled substance accountable records are maintained in the SAMMS and are readily retrievable for Schedule III, IV, and V items. The items can be logically extracted and hard copies can be produced within a maximum 24-hour period.

Audit Response. We did not consider DPSC's records of controlled substances to be readily retrievable, therefore, we consider DLA's comment nonresponsive. Title 21, CFR 1304.01(h), states:

> The term *readily retrievable* means that certain records are kept by automatic data processing systems or other electronic or mechanized record-keeping systems in such a manner that they can be separated out from all other records in a reasonable time and/or records are kept on which certain items are asterisked, redlined, or in some other manner visually identifiable apart from other items appearing on the records.

Title 21, CFR 1304.04(f)(2), states: "Inventories and records of controlled substances listed in Schedules III, IV, and V shall be maintained either separately from all other records of the registrant or in such form that the information required is readily retrievable from the ordinary business records of the registrant." As discussed previously, when the auditors asked for records of controlled substances, the DPSC provided an 863 page computer listing of Federal Supply Class 6505 items. Controlled substances were commingled with all other items in that FSC and were not annotated to permit ready identification.

DLA Position on Recommendation 2.c. DLA nonconcurred, stating that the audit contains a basic misconception about who "owns" the material that was processed for disposal. DLA stated that accountability is transferred from the DPSC to the DRMO when the DPSC receives the Materiel Release Confirmation (MRC) from the DLA depot. Although the balance has been decreased from the National Inventory Record, the DPSC maintains an unconfirmed Disposal Release Order, which is subjected to mechanical follow-up processing, until the MRC is received and closes out the DPSC file. Given this process, the DPSC maintains accountable records for all controlled substances from receipt until final disposition.

Audit Response. We consider DLA's comments nonresponsive. The DRMO does not accept accountability for controlled substances. The DPSC cannot delegate accountability for controlled substances to the storing depot. Under current procedures, when a controlled substance is determined to be unserviceable, the DPSC abandons inventory and financial control over the item, thus accountability is lost. Neither the DPSC nor the depots could provide documentary evidence to prove that all the variances between the quantities of unserviceable, controlled substances dropped from accountable records and the audit counts of unserviceable stocks on hand had, in fact, been destroyed.

DLA Position on Recommendation 2.d. DLA nonconcurred, stating that the DPSC does research discrepancies on shipments of controlled substances, regardless of dollar value. Also, DLA depots must report unresolved adjustments on controlled substances to the Command Security personnel for investigation.

Audit Response. We consider DLA's comments partially responsive. During the audit, DPSC officials told auditors that for a relatively short time, DPSC did give credit to customers without determining the disposition of missing controlled substances. DPSC corrected this deficiency in October 1991. DLA did not indicate that the corrective action included reporting shipping discrepancies to the DEA. In accordance with title 21, CFR, shipment discrepancies on controlled substances must be reported to the DEA.

Response Requirements Per Recommendation

Response to the final report is required from the addressees shown for the items indicated with an "X" in the chart below.

		Response Should Cover			
Number	Addressee	Concur or Nonconcur	Proposed Action	Completions Date	Related Issue[1]
1.a.[2]	DLA	N/R[3]	N/R[3]	X	IC
1.b.[4]	DLA	X	X	X	IC
1.c.	DLA	X	X	X	IC
1.d.	DLA	X	X	X	IC
1.e.[4]	DLA	X	X	X	IC
2.a.	DLA	X	X	X	IC
2.b.	DLA	X	X	X	IC
2.c.	DLA	X	X	X	IC
2.d.	DLA	X	X	X	IC

[1] Internal Controls.

[2] Combined Recommendations 1.a.(1) and 1.a.(2).

[3] No Response Required.

[4] New Recommendation.

Part III - Additional Information

Appendix A. Sampling Plan

Statistical Sampling Plan and Methodology. The audit universe was the inventory of controlled substances as of May 1991. The universe was divided into four strata based on the dollar value of the line items in inventory at Memphis, Tennessee; Mechanicsburg, Pennsylvania; and Tracy, California (Ogden, Utah, had only three line items). The depots were also stratified according to the dollar value of line items stored. The sample was comprised of randomly selected line items from the four strata based on dollar value and number of line items stored at the depots.

Table 1. Sample Strata

Strata	Criteria
1	Line item inventory value greater than $100,000.
2	Line item inventory value equal to or greater than $10,000 but less than $100,000.
3	Line item inventory value equal to or greater than 1,000 but less than $10,000.
4	Line item inventory value less than $1,000.

Line items were stratified based on the dollar value of stock stored at each depot as of May 1991, according to DPSC records. The data base for the DPSC inventory of controlled substances consisted of 119 line items with a total value of $5.7 million. The audit universe contained 268 line items because some line items were stored at more than one DLA depot, and because each line item was counted as a separate line item at each DLA depot. The audit universe is summarized below.

Table 2. Universe

(lines/$ value [000's])

Strata	Memphis	Mechanicsburg	Tracy	Ogden	Totals
1	2/$574	7/$1,803	5/$ 867	0/$ 0	14/$3,244
2	8/$188	37/$1,322	18/$ 498	1/$29	64/$2,037
3	22/$ 77	36/$ 152	43/$ 192	0/$ 0	101/$ 421
4	27/$ 8	30/$ 7	30/$ 11	2/$ 1	89/$ 27
Totals	59/$847	110/$3,284	96/$1,568	3/$30	268/$5,729

A stratified sample totaling 105 line items drawn from the May 1991 data base was statistically selected to be inventoried. In addition, 34 reverse sample items picked at random from the warehouse floor were inventoried; thus, a total of 139 line items were included in the count. The total value of the sample was $4.8 million. Details on the sample are shown in the following table.

Table 3. Sample

(lines/$ value [000's])

Strata	Memphis	Mechanicsburg	Tracy	Ogden	Totals
1	3/$ 682 *	8/$1,926 *	6/$ 979 *	0/$ 0	17/$3,587 *
2	14/$ 405 *	14/$ 342	12/$ 219	1/$ 29	41/$ 995
3	12/$ 49	13/$ 54	16/$ 72	0/$ 0	41/$ 175
4	11/$ 3	11/$ 3	10/$ 2	8/$ 1 *	40/$ 9
Totals	40/$1,139	46/$2,325	44/$1,272	9/$ 30	139/$4,766

* Figures exceed universe because items found at the depots were not on accountable records as of May 1991.

Since the actual inventories were taken in November 1991, the sample results were adjusted to the May 1991 inventory levels and accordingly, the statistical projections were based on the May universe data.

Appendix B. Analysis of Line Items with Variances

The results of the audit count of the sample line items that had variances and the results after reconciliation with DPSC's accountable records are shown below.

Item No.	Nomenclature	SC[1]	U/I[2]	Unit Price	Audit Count	DPSC Record	Original Quantity Variance[3]	Variance After Reconciliation Quantity Over	Quantity Short	Dollar Value Over	Dollar Value Short
1.	Morphine Injection	R	BX	$4.84	69,007	56,413	12,594	12,594	0	60,955	0
2	Diazepam Injection	Q	PG	14.20	15,899	15,239	660	660	0	9,372	0
3.	Meperidine Hydrochl	R	PG	3.93	44,897	44,696	201	0	0	0	0
4.	Fentanyl Citrate In	R	PG	3.09	70,910	70,905	5	0	0	0	0
5.	Oxycodone Hydrochlo	R	BX	8.36	2,125	2,067	58	0	0	0	0
6	Morphine Sulfate In	R	PG	8 75	16,291	148	16,143	0	0	0	0
7	Alcohol Dehydrated	R	BT	80	5,005	1,897	3,108	0	(15)	0	(12)
8.	Meperidine Hydrochl	R	PG	3.69	4,819	4,774	45	0	0	0	0
9.	Midazolam Hydrochlo	Q	PG	431.74	110	109	1	0	0	0	0
10.	Chlordiazepoxide Hy	Q	PG	35.79	782	784	(2)	0	0	0	0
11.	Oxycodone Hydrochlo	R	BT	1.20	824	197	627	0	0	0	0
12	Flurazepam Hydrochl	Q	BT	16.52	268	267	1	0	0	0	0
13	Morphine Sulfate Ex	R	BT	18.43	312	309	3	0	0	0	0
14.	Codeine Phosphate A	Q	BX	6.93	221	206	15	0	0	0	0
15.	Diazepam Tablets Nf	Q	BT	4.05	7,548	7,672	(124)	0	0	0	0
16.	Meperidine Hydrochl	R	PG	3.46	11,208	11,204	4	0	0	0	0
17.	Terpin Hydrate And	Q	BT	1.17	39	26	13	0	0	0	0
18	Temazepam Capsules	Q	BT	6 03	22	3	19	0	0	0	0
19	Methylphenidate	R	BT	5.91	3,100	2,265	835	0	0	0	0
20.	Ethyl Alcohol	R	DR	17.87	1	0	1	0	0	0	0
21.	Acetaminophen & Cod	Q	BX	31.02	1,056	1,062	(6)	0	0	0	0
22.	Diphenoxylate	Q	BX	2.20	1,548	1,544	4	0	0	0	0
23.	Alprazolam Tablets	Q	BT	24.68	3,023	2,939	84	84	0	$2,073	0
24.	Thiopental Sodium	Q	PG	78 14	2,234	1,537	697	0	(89)	0	($6,954)
25	Methylphenidate Hyd	R	BT	221 27	156	0	156	0	0	0	0
26.	Meperidine Hydrochl	R	PG	3.93	2,044	1,936	108	108	0	424	0
27.	Diazepam Injection	Q	PG	3.40	1,112	1,112	0	0	0	0	0
28.	Flurazepam Hydrochl	Q	PG	8.94	26	0	26	0	0	0	0
29	Hydromorphone Hyrro	R	BT	10.78	469	697	(228)	0	(229)	0	(2,468)
30	Terpin Hydrate And	Q	BT	1 17	11	10	1	0	(2)	0	(2)

*See footnotes at end of table

Appendix B. Analysis of Line Items With Variances

Item No.	Nomenclature	SC[1]	U/I[2]	Unit Price	Audit Count	DPSC Record	Original Quantity Variance[3]	Variance After Reconciliation Quantity Over	Quantity Short	Dollar Value Over	Dollar Value Short
31	Codeine Phosphate	Q	BT	3.04	6,026	5,959	67	0	0	0	0
32.	Thiopental Sodium	Q	BX	376.16	165	165	0	0	0	0	0
33.	Codeine Phosphate	Q	BT	14.59	3,178	3,180	(2)	0	(2)	0	(29)
34.	Pemoline Tablets	Q	BT	57.20	107	61	46	0	0	0	0
35	Clonazepam Tablets	Q	BT	49.51	2,190	2,140	50	0	0	0	0
36	Meperidine Hydrochl	Q	PG	4.17	4,342	4,224	118	0	0	0	0
37	Propoxphene Napsyl	Q	BT	42 31	251	251	0	0	0	0	0
38.	Fluoxymesterione Ta	Q	BT	80.95	756	744	12	0	0	0	0
39.	Alprazolam Tablets	Q	BT	24.68	8	0	8	0	0	0	0
40.	Codeine Phosphate U	R	BT	52 68	4,935	5,068	(133)	0	(133)	0	(7,006)
41	Midazolam Hydrochlo	Q	PG	431.74	498	396	102	0	0	0	0
42.	Meperidine Hydrochl	R	PG	4 48	49,447	44,434	5,013	2,516	0	11,272	0
43.	Diazepam Injection	Q	PG	14.49	26,829	24,875	1,954	1,954	0	28,313	0
44.	Alcohol Dehydrated	R	BT	.82	21,410	21,477	(67)	0	(67)	0	(55)
45.	Thiopental Sodium F	Q	BX	376.16	1,426	1,228	198	194	0	72,975	0
46.	Methylphenidate Hyd	R	BT	28.61	1,224	0	1,224	0	(120)	0	(3,433)
47.	Phenobarbital Table	Q	BT	1.93	5,325	5,322	3	0	0	0	0
48	Terpin Hydrate And	T	17	93	32	61	0	0	0	0	0
49.	Meperidine Hydrochl	BT	.49	1,771	1,761	10	0	0	0	0	0
50.	Alfentanil Hydrochl	R	PG	42.92	349	128	221	0	0	0	0
51.	Chlordiazepoxide Hy	Q	PG	35 79	53	14	39	0	0	0	0
52.	Meperidine Hydrochl	R	PG	3.69	60	7	53	0	(1)	0	(4)
53.	Diazepam Tablets Nf	Q	BT	3 84	1,910	2,062	(152)	0	(152)	0	(584)
54.	Midazolam Hydrochlo	Q	PG	231.77	23	23	0	0	0	0	0
55.	Meperidine Hydrochl	R	BX	3.08	946	946	0	0	0	0	0
56.	Meperidine Hydrochl	R	PG	3.53	2,625	2,628	(3)	0	(3)	0	(11)
57.	Diphenoxylate Hydro	Q	BT	3.28	3,380	2,427	953	0	0	0	0
58.	Codeine Phosphate A	Q	BT	14.59	1,251	1,179	72	72	0	1,050	0
59.	Midazolam Hydrochlo	Q	PG	106.86	1,225	1,243	(18)	0	(18)	0	(1,923)
60	Diazepam Tablets Nf	Q	PG	6 67	75	71	4	0	0	0	0
61	Codeine Sulfate Tab	R	BT	11 56	355	1,431	(1,076)	0	(1,076)	0	(12,439)
62.	Meperidine Hydrochl	R	PG	4.09	10,475	10,667	(192)	0	0	0	0
63.	Oxycodone Hydrochlo	R	BT	1.21	2,891	3,085	(194)	0	(194)	0	(235)
64.	Morphine Sulfate In	R	PG	8.75	12,869	8,344	4,525	0	(76)	0	(665)
65.	Actaminophen Tabs	Q	BT	15.81	1,988	2,058	(70)	0	0	0	0
66	Codeine Phosphate A	Q	BX	17.13	3,435	3,437	(2)	0	(52)	0	(891)
67.	Fentanyl Citrate In	R	PG	3.45	26,194	24,497	1,697	0	(7,126)	0	(24,585)
68.	Diphenoxylate	Q	BX	2.22	1,407	2,719	(1,312)	0	(1,312)	0	(2,913)
69.	Alcohol Usp	R	BT	17.87	4	0	4	0	0	0	0
70.	Diphenoxylate Hydro	Q	PG	3.28	2	0	2	0	0	0	0

*See footnotes at end of table

Appendix B. Analysis of Line Items With Variances

Item No.	Nomenclature	SC[1]	U/I[2]	Unit Price	Audit Count	DPSC Record	Original Quantity Variance[3]	Variance After Reconciliation Quantity Over	Quantity Short	Dollar Value Over	Dollar Value Short
71.	Diazepam Injection	Q	PG	3.40	2	2	0	0	0	0	0
72.	Propoxyphene Napsyl	Q	BT	15.81	2	2	0	0	0	0	0
73.	Triazolam Tablets	Q	BT	16.54	3	3	0	0	0	0	0
74.	Diazepam Tablets Nf	Q	BT	$ 4.05	1	0	1	0	0	0	0
Totals:								18,182	(10,667)	$186,434	($64,208)

1 S/C - Security Code

2 U/I - Unit of Issue

3 Net variance between the audit count and DPSC record quantity for all condition codes excluding Code H (unserviceable).

Appendix C. Statistical Sampling Projections

The following estimates of inventory overages and shortages in the audit universe were based on the 105 statistically selected line items that comprised the stratified sample. Although the audit included a reverse sample of 34 additional line items, reverse sample results were not used for statistical projections because those results could not be reliably adjusted to the May 1991 inventory levels.

Table 1. Statistical Projections

	Memphis	Mechanicsburg	Tracy	Total[1]
Overage Projections	$133,049	$244,307	$440,052	$817,408
Margin of Error[2] with 90-percent confidence level	+/-3,559	+/-138,608	+/-61,920	+/-151,852
Range of Values	$129,490 $136,608	$105,699 $382,915	$378,132 $501,972	$665,556 $969,260
Shortage Projections	$15,397	$166	$17,762	$33,325
Margin of Error[2] with 90-percent confidence level	+/-3,351	+/-59	+/-9,005	+/-9,682
Range of Values	$12,046 $18,748	$107 $225	$8,757 $26,767	$23,717 $42,933

[1] Total reflects amounts for three depots shown because there were no quantity discrepancies at the Ogden depot.

[2] The estimated total margin of error (ME) is the square root of the sum of the squares of the MEs.

The actual dollar values of variances discovered in the reverse sample are shown below.

Table 2. Dollar Values of Variances

Depot	Overages	Shortages
Memphis	$ 6,774	$ (29)
Mechanicsburg	4,962	(186)
Tracy	48,554	(8,763)
Totals	$60,290	$(8,978)

Appendix D. Undocumented Adjustments of Records

The audit showed that supporting documentation was not available for the following adjustments to records of controlled substances.

Controlled Substances	Undocumented Record Adjustments			
	DEPOT		DPSC	
	Date[1]	Quantity	Date[1]	Quantity
Thiopental	June 20	88	Oct. 24	(774)
Thiopental	July 24	(1,533)	Oct. 24	(727)
Meperidine Hyd	June 12	(3,985)	n/a[2]	n/a[2]
Diazepan Inj	July 12	(551)	Oct. 29	(356)
Propoxyphene Nap	June 13	314	n/a[2]	n/a[2]
Hydromorphone	June 14	(53)	n/a[2]	n/a[2]
Terpin Hydrate	July 12	(1)	Aug. 16	(1)
Codine Phosphate	June 07	(3,660)	Oct. 30	(3,672)
Codine Phosphate	June 07	1	n/a[2]	n/a[2]
Fluoxymesterone	Aug. 10	232	n/a[2]	n/a[2]

[1] All dates are in 1991.
[2] n/a - Not applicable.

Appendix E. Analysis of DPSC Variance Report

The following chart illustrates that DLA depots delayed reporting inventory variances to DPSC for up to 4 to 5 months.

	Nomenclature	Audit Variance Over/Short	Variance On Discrepancy Report	Unit Price	$Value of Variance	Audit Count Date	Date Variance Reported to DPSC	Research Completed By DPSC
1	Alprazolam Tab.	84	84	$25 17	$2,114	11/13/1991	02/27/1992	03/11/1992
2	Hydromorphone Hydro	(288)	(288)	10 78	2,458)	11/14/1991	02/08/1992	No
3.	Codeine Phosphate	(2)	(2)	14.59	(29)	11/14/1991	02/07/1992	No
4.	Diazepam Injection	660	660	14.49	9,563	10/28/1991	02/28/1992 *	No
5.	Fentanyl Citrate	5	5	3.45	17	10/28/1991	02/29/1992 *	No
6.	Alcohol, Dehydrated	(15)	(15)	.82	(12)	10/28/1991	03/17/1992 **	No
7.	Merperidine Hydrochl	45	45	4.17	188	10/30/1991	02/29/1992 *	No
8.	Chloriazepoxide	(2)	(2)	36.51	(73)	10/28/1991	02/29/1992 *	No
9.	Morphine Sulfate	3	3	18.80	56	10/28/1991	02/29/1992	03/17/1992
10.	Codeine Phosphate	15	15	7.07	106	10/30/1991	02/29/1992 *	No
11.	Merperidine Hydrochl	4	4	3.53	14	10/30/1991	02/27/1992 *	No
12.	Temazepam Capsules	19	19	6.03	121	10/31/1991	01/09/1992	01/18/1992
13	Ethyl Alcohol	1	1	20.37	20	10/29/1991	02/08/1992 *	No
14	Acetaminophen & Cod	(6)	(6)	30.74	(184)	10/28/1991	02/28/1992 *	No
15.	Alprazolam Tablets	8	8	25.17	201	11/21/1991	12/28/1991	01/20/1992
16	Terpin Hydrate	161	161	1.19	190	11/20/1991	12/13/1991	12/21/1991
17.	Merperidine Hydrochl	10	10	6.63	66	11/23/1991	12/13/1991	12/21/1991

* Variance was not reported for about 4 months.
** Variance was not reported for about 5 months.

Appendix F. Summary of Unserviceable, Controlled Substances

The following table shows unserviceable, controlled substances that could not be physically located and for which there was no documentation of destruction or other disposition.

Nomenclature	CSA SCH[1]	SC[2]	Unit Price	Audit Count[3]	Depot Record	DPSC Record	Quantity Missing[4]	Dollar Value
Merperidine Hydrochl	II	R	$ 4.48	2,497	6,047	5,407	2,910	$13,037
Diazepam Injection	IV	Q	14 49	1,625	15,868	15,726	14,101	204,323
Thiopental Sodium	III	Q	376.16	5	415	415	410	154,226
Chlordiazepedoxide	IV	Q	36 51	39	42	42	3	110
Diphenoxylate Hydro	V	Q	3.35	0	236	207	207	693
Phenobarbital Elixir	IV	Q	11.56	2	0	9	7	81
Morphine Sulfate	II	R	8.75	0	15	2	2	18
Diphenoxylate Hydro	V	Q	2.22	0	569	23	23	51
Thiopental Sodium	III	Q	78.14	818	2,664	2,319	1,501	117,288
Flurazepam Hydrochl	III	Q	19 08	108	134	158	50	954
Codeine Phosphate	III	Q	3 04	0	7,324	7,324	7,324	22,265
Total								$513,046

1 Controlled Substance Act schedule.

2 Security code.

3 Audit count includes items listed on destruction documents

4 Missing quantity is based on DPSC record quantity less the audit count quantity.

Appendix G. Missing Shipments

Actions taken by DPSC on customer complaints of controlled substances missing from shipments are summarized below.

	Credit Given		Carrier Liable		Dollar Value (Not Met)*		No Action		Total	
Depot	No. of Items	$Value	No. of Items	$Value	No. of Items	$Value	No. of Items	$Value	No. of Items	$Value
Mechanicsburg	19	$10,950	7	$ 6,320	12	$ 281	1	$513	39	$18,064
Memphis	12	2,833	8	5,280	15	537	0	0	35	8,650
Tracy	14	7,709	4	16,054	17	383	4	3,680	39	27,826
Totals	45	$21,492	19	$27,654	44	1,201	5	$4,193	113	$54,540

* Dollar value of individual items less than $50 00

Appendix H. Summary of Potential Benefits Resulting from Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
1.a.	Internal Controls. Requires quarterly inventories of controlled substances.	Nonmonetary.
1.b.	Internal Controls. Requires resolution of automated information system errors impacting the stock record accuracy for controlled substances.	Nonmonetary.
1.c.	Internal Controls. Requires accountability over unserviceable, controlled substances until final disposition.	Nonmonetary.
1.d.	Internal Controls. Requires that controlled substances be subjected to formal vulnerability assessments.	Nonmonetary.
1.e.	Internal Controls. Prevents undocumented record adjustments for controlled substances	Nonmonetary.
2.a., b., c., d.	Compliance and Internal Controls. Establish controls that comply with title 21, Code of Federal Regulations.	Nonmonetary.

Appendix I. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
Assistant Secretary of Defense for Personnel and Readiness
Deputy Under Secretary of Defense for Logistics

Defense Agencies

Defense Logistics Agency, Alexandria, VA
- Defense Personnel Support Center, Philadelphia, PA
- Defense Distribution Region East, Mechanicsburg, PA
- Defense Distribution Region Central, Memphis, TN
- Defense Distribution Region West, Tracy Location, Tracy, CA
- Defense Depot, Ogden, UT

Non-DoD Organizations

Department of Justice
- Drug Enforcement Administration, Washington, DC
- Drug Enforcement Administration Regional Office, Philadelphia, PA

Appendix J. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
Assistant Secretary of Defense for Personnel and Readiness
Deputy Under Secretary of Defense for Logistics
Assistant to the Secretary of Defense for Public Affairs
Comptroller of the Department of Defense
General Counsel, Department of Defense
DoD Coordinator for Drug Enforcement Policy and Support

Department of the Army

Inspector General
Auditor General, Army Audit Agency

Department of the Navy

Assistant Secretary of the Navy (Financial Management)
Auditor General, Naval Audit Service

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Air Force Audit Agency

Defense Agency

Defense Logistics Agency
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency

Non-DoD Organizations

Office of Management and Budget
Office of National Drug Control Policy

Non-DoD Organizations (Cont'd)

Department of Justice
Inspector General
Narcotic and Dangerous Drugs Section, Criminal Division
Drug Enforcement Administration
Drug Control Section, Operations Division
Philadelphia Regional Office
U.S. General Accounting Office, National Security and International Affairs Division, Technical Information Center

Chairman and Ranking Minority Member of Each of the Following Congressional Committees and Subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Subcommittee on Labor, Health and Human Services and Education, Committee on Appropriations
Senate Subcommittee on Commerce, Justice, State, the Judiciary and Related Agencies, Committee on Appropriations
Senate Committee on Armed Services
Senate Subcommittee on Readiness Sustainability and Support, Committee on Armed Services
Senate Committee on Labor and Human Resources
Senate Subcommittee on Children, Family, Drugs and Alcoholism, Committee on Labor and Human Resources
Senate Committee on Governmental Affairs
Senate Drug Enforcement Caucus, Senate Caucuses
House Committee on Appropriations
House Subcommittee on Commerce, Justice, State, the Judiciary and Related Agencies, Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Subcommittee on Readiness, Committee on Armed Services
House Committee on Energy and Commerce
House Subcommittee on Health and the Environment, Committee on Energy and Commerce
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations
House Select Committee on Narcotics Abuse and Control

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Part IV - Management Comments

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

09 FEB 1993

IN REPLY REFER TO DLA-CI

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: DoD IG Draft Audit Report on Controls Over Wholesale Drug Inventories at the Defense Logistics Agency (Project No. 1LA-0028)

This is in response to your 06 November 1992 request. In addition to our response to the findings and recommendations, we have provided additional detailed comments on selected parts of the report.

9 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Division
Office of Comptroller

cc:
DLA-O
DLA-LR
DDRE
DPSC
DRMS

DATE OF APPROVAL:
05 FEB 1993

DEFENSE LOGISTICS AGENCY SPECIFIC COMMENTS ON DOD IG DRAFT REPORT ON CONTROLS OVER WHOLESALE DRUG INVENTORIES AT THE DEFENSE LOGISTICS AGENCY (PROJECT NO. 1LA-0028)

Part I - Background

Paragraph 3: The report reflects an apparent misunderstanding of the differing missions between an Inventory Control Point, such as DPSC, and a distribution depot, such as the defense depots cited in subject report DPSC does not "warehouse" the controlled substances; DPSC manages, procures and directs distribution The defense depots receive, store, issue, provide physical security and conduct physical inventories and associated research but they do not manage the items.

Paragraph 4: The total dollar value of DPSC's inventory was $511 million. DPSC did not spend $511 million to procure controlled substances, as stated in the draft report.

Part I - Scope

Paragraph 2: The audit states that "Physical inventory count quantities were compared to record quantities and transaction history data was reviewed to resolve discrepancies". DPSC, upon receipt of the audit recommendations, reviewed the alleged unresolved discrepancies and found that the quantities which were quoted as being DPSC record quantities could not be located on DPSC accountable record transaction history files in all but one instance. The transaction history files also revealed that numerous supply transactions that increment and decrement onhand quantities were occurring while the items were being inventoried. Additionally, multiple ownership accounts and condition codes were affected. The audit makes no reference to, nor provides evidence of, physical count adjustments resulting from day-to-day transaction processing prior to, during, or after the inventories were conducted. DLA Centers, Depots and Headquarters personnel have consistently and continually attempted to educate auditors to accurate inventory procedures when inventories are not performed in a shut-down, wall-to-wall environment. Supply transactions occurring pre- and post-inventory cutoff must be considered in relation to the physical count prior to any record comparison. These "in-float" documents include receipts, issues, reclassification (condition code change), adjustments, logistical transfers, etc. When these business transactions are not considered, such as in the case of the audit sample inventories, variances which do not truly exist will be claimed

TAB A

Part I - Internal Controls

Paragraph 1: 'Specifically, required inventories were not conducted, accounting records were inaccurate, and stock quantities unknown.' The data and information collected by the auditors' does not substantiate these conclusions. This sentence needs to be qualified in order to put the report in a proper perspective. First, 'inventories were not conducted'. DPSC directs the quarterly inventories in 99.9% of the cases and the depot completes the large majority of inventories as requested (approximately 94%). There are varying, legitimate reasons for 'Dates of Last Inventory' exceeding the per-quarter rule. For example, preadjustment research may reveal the unposted or incorrectly posted supply transaction The inventory may be cancelled in order to allow for time to post the correct transaction and preclude an inventory adjustment. Significant activity may hamper efforts to accurately control infloat documentation. Still other reasons include Document Identifier Code DKA, Inventory Count Transaction, violations which are monitored by Inventory & Accounting personnel and Stock Control Division management These violations may be properly processed but may not result in the Date of Last Inventory being updated.

'... accounting records were inaccurate, and stock quantities unknown.' This should be reworded to indicate that the large majority of required inventories are completed and that accountable and custodial records are considerably accurate. Our official comments are contained in the DLA comments to Finding A.

The report indicates a misunderstanding of the disposal process. Disposition instructions for unserviceable controlled substances are provided to the storage facility via electronic transmission of discrepancy report information and Disposal Release Orders (DRO) prior to the actual physical disposal action. The unconfirmed DRO will remain in the accountable activity's on-line files until such time as the depot confirms shipment to the DRMO. These files are subjected to mechanical followup procedures. In the depot, the custodial files will still reflect a location and open DRO until the materiel is selected and the DRO is confirmed as shipped. Accountability for materiel is transferred and/or shipped to the DRMO from the distribution activity. The DRMO becomes the accountable office and officer for the materiel; therefore, the DRMO is responsible for compliance with DLAR 4145.11 and Title 21, CFR. Should a depot fail to receive or process the disposal action, one of four processes would 'flag' this discrepant situation: unconfirmed/overaged DRO followup; subsequent physical inventory; Depot Balance & Transaction Register monthly reconciliation; or the semi-annual location reconciliation.

Additionally, ". . missing shipments of controlled substances, with individual item values of less than $50, were not researched and resolved." Whenever a missing shipment transaction valued at less than $100 is processed to close a contract file (DLAM 4140.2, Vol II, Part III, Appendix E389P, Section X and DLAM 8100.1), the Standard Automated Materiel Management System (SAMMS) automatically generates a mandatory research document, regardless of dollar value, when the item is a controlled substance (DLAM 4140.2, Vol II, Part II, Appendix D14). These are researched by the accountable staff and, if unresolved, trigger a Letter of Investigation to the applicable depot. If still unresolved, the depot will initiate a Financial Liability Investigation for Property Loss (FLIPL) and will provide the adjustment data and research findings to the Depot Command Security personnel.

Part I - Prior Audits and Other Reviews

The audit report cites two General Accounting Office (GAO) reports, dated 24 Dec 87 and 24 Nov 84, five (5) and eight (8) years old, respectively. The draft report reiterates the findings and recommendations but does not indicate whether the auditors found evidence that the findings still are valid. The report repeats the GAO finding that "inventory accuracy records need to consider record adjustments valued under $800." Insofar as controlled items are concerned, all record adjustments processed by the storage activity and DPSC are considered for all controlled substances regardless of dollar value. SAMMS generates a mandatory research document on a controlled substance adjustment even when the value of an item is equal to one cent. Depots performed post-count validation and preadjustment research on all controlled item potential variances.

The report repeats a recommendation that the DLA "require the Mechanicsburg depot to correct known security problems". Those "known security problems" such as POV parking restrictions, limited access to restricted areas, installation of security devices, etc., have long since been corrected.

The report repeats a finding that prescription and non-prescription drugs and medicines were stored in a warehouse with unrestricted access. Although prior audits found drug items stored outside the vault, those items were coded with a Physical Security Code of "U", Uncontrolled Item. Although not in a secure building, the building they were stored in had restricted access and has since been converted to secure; i.e., in compliance to store pilferable items ("J" coded). The drugs the GAO auditors found in this building were over-the-counter aspirin. All items are stored according to their Physical Security Code. Depots review DWASP generated reports to ensure all "Q", "R" and "J" coded items are stored in an appropriate restricted/secure location. Additionally, this is an area reviewed annual by Headquarters in the Technical Assistance and Operational Review visits.

Additionally, the report repeats a recommendation that "DPSC direct the DoD components to require each customer to monitor receipt of materiel..." DoD Components do monitor receipt of materiel and other assets as an internal control responsibility. It is mandatory that any variation concerning receipt of materiel, commercial or other source, be reported by the storage facility to DPSC via a Report of Discrepancy (ROD) per DLAM 4140.2, Vol II, Part III, Appendix E398P and Vol III, Part III, Chapter 68, and DoD 4000.25-2-M. If the problem is traced to the carrier, the Customer/Depot Compliant System tracks this data. Overdue shipments from new procurement sources are identified and tracked by SAMMS and the Project ACTION programs (DLAM 8100.1).

We are not sure the relevance of quoting aged audit reports when there is no evidence in the draft report that substantiates those cited findings/recommendations as being repeated or otherwise still unresolved. It is also clear that the auditors did not expand their focus to include all available mechanical and procedural tools to identify and quantify our efforts and performance in tracking and controlling the movement of controlled substances.

Part II - Management of Controlled Substances

It would appear that the basis of the alleged overages and shortages is the series of comparisons that the audit team made between actual depot onhand balances versus DPSC balances (DPSC balances that could not be verified). The draft extrapolates the apparent imbalances from the sample to the universe of controlled substances. Given the lack of establishment of control over infloat transactions, these extrapolations are questionable at best.

Discussion of Details

Accounting Records:

Paragraphs 1 and 2: Controlled substance records and transactions are recorded and identified within SAMMS and they are readily retrievable in accordance with Title 21, CFR. These records can be extracted and hard copies produced within a maximum 24 hour timeframe for all controlled items. DPSC assigns different Physical Security, Special Item and Inventory Category Codes to Schedule III, IV and V items in accordance with Public Law 91-513 as stated in DLAR 4145.11. Additionally, all transactions processed to any item are maintained in SAMMS for a period of two years.

Paragraph 3: DPSC did report controlled substance procurements to DEA as required DEA is aware of every controlled substance procurement made by DPSC. With each buy for the depot or for direct vendor delivery to a customer, a DEA 222 Form is processed. As for formal quarterly reporting, DPSC is exempt from the Automation of Reports and Consolidated Orders System (ARCOS) reporting regulations contained in Title 21, CFR. Our ARCOS reporting status code is "G" (non-reporting status). The DEA has cognizance over auditing controlled substances, and audits DPSC every three years. Their last audit was conducted in March 1990, at which time they reviewed our procedures for processing DEA 222 Forms, and did not cite us for not submitting formal quarterly reports, nor did they cite any of the accounting concerns stated in this audit.

Inventories:

Paragraphs 1 and 2: Quarterly inventories of controlled substances are conducted as required. A review of DPSC's inventory scheduling and completion reports for 1991 and 1992 was conducted and it revealed that 99.9% of all schedule II controlled substances were scheduled by DPSC each quarter. Approved MILSTRAP Change Letter (AMCL) 8, dated 25 March 1991, authorizes cancellation of inventories when conditions exist that preclude the accurate completion of an inventory, which include, but are not limited to, catalog changes, rewarehousing, insufficient resources, insufficient time to meet established inventory timeframes to notify affected owners, and acts of God. As a means of maintaining control and retaining visibility of cancelled inventories, both SAMMS and DWASP generate reports that identify the cancelled inventories. These reports are used to reschedule any inventories as deemed appropriate. At depots, inventories are conducted on a quarterly basis for all Physical Security Code "Q" and "R" items, controlled substances and precious metals. The inventories are complete, wall-to-wall, and are conducted by trained inventory personnel assigned to the "vault" and who are intimately familiar with the medical commodities. As an extra precaution, to ensure all vault items are inventoried, the depots preinventory surveys and scan locator files for vault locations. When an item is not flagged for inventory, the depots either initiate the inventory request internally or work with DPSC to initiate the inventory through the SAMMS.

All discrepancies found during inventory are researched, regardless of dollar value. Post-count validation and preadjustment research takes place prior to release of the inventory count to DPSC. In the Mechanicsburg depot's case, considering the proximity to DPSC, when cause for the discrepancy between the accountable and custodial records cannot be resolved by the depot, a team from Mechanicsburg is dispatched to DPSC to compare transaction histories and reconcile the differences.

Paragraph 3: The alleged imbalances occurred because the auditors chose, after discussing formal inventory processing/ procedures with DPSC personnel, to essentially conduct warehouse counts in lieu of establishing formal inventories. Formal inventories cause the establishment of Inventory Cutoff Dates (ICODs) and generating Strike or Cutoff Date Balances in the SAMMS and DWASP systems. The Inventory Control Master File and the Inventory Document Control File are the means by which pre-inventory and post-inventory infloat documents are controlled. The Mechanicsburg depot also confirms that the auditors did conduct warehouse counts instead of control inventories and DDSP found the alleged variances were due to infloat transactions not being properly accounted for by the auditors.

Paragraphs 4 and 5: The auditors state that "variances occurred because of transactions that had been processed on the DPSC record but not on the depot records because the substances had not yet been shipped." This is a classical example of infloat. DPSC used the analogy of a "check that hadn't cleared yet" to explain to the auditors the purpose of controlling infloat transactions via formal inventory. This lack of adherence to accurate inventory processing clearly invalidates the auditors sample results and projections to the controlled substance universe.

Paragraph 6: The audit states that there were 73 out of 74 line items which reflected unresolved variances. We reiterate that the alleged variances occurred because formal inventories were not scheduled to control infloat documents. It is true that, occasionally, a transaction could appear on one record and not the other, but the SAMMS/DWASP systems have an automated interface mechanism to catch these types of systems mismatches. It is called the Depot Balance & Transaction Register (DB&TR) reconciliation program. This program reconciles balances and transactions between the DWASP and SAMMS files, generating research documents used to correct incompatabilities between these records. The auditors do not indicate that they even used this information, which is invaluable in detecting transactional incompatabilities that affect the balance.

Unserviceable Stocks

Paragraph 1: We reiterate the comments made earlier in Part I - Internal Controls. Additionally, unserviceable stocks having been disposed are still "controlled" substances. When a DRO is received, the depot must hold the materiel until DRMO can arrange for proper disposal. Although it is dropped from DPSC records and the depot's inventory, it is properly picked up on DRMO's records, thus maintaining the audit trail and accountability. Any inventories to be conducted after disposal would be conducted by DRMO; depots should not inventory stock no longer officially on their inventory record.

Paragraphs 1, 2, and 3: As stated previously, DPSC is exempt from the ARCOS reporting.

Shipping Losses

All controlled substances shipped from DLA depots are shipped via signature service only. In many cases, customers have complained about missing items that the depot finds the customers actually signed for as received

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101.

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

FINDING A: MANAGEMENT OF CONTROLLED SUBSTANCES. Management of wholesale stocks of controlled substances within the DLA needed improvement. Separate accounting records had not been established for controlled substances; stock records were inaccurate; unserviceable, controlled substances were dropped from accounting records before final disposition; and all losses of controlled substances in transit had not been investigated This condition occurred because the DPSC had not fully implemented the procedures required by the CSA for managing controlled substances, and because management at all levels did not ensure compliance with the procedures that had been established. As a result, inventory overages totaled about $817,408; inventory shortages totaled about $33,325; the disposition of unserviceable, controlled substances valued at $513,046 was not documented; and the disposition was unknown for controlled substances, valued at $54,540, that were missing in transit.

DLA COMMENTS:

o Nonconcur. "Separate accounting records had not been established for controlled substances." Controlled substance records and transactions are recorded and identified within SAMMS and they are readily retrievable in accordance with Title 21, CFR. These records can be extracted and hard copies produced within a maximum 24 hour timeframe for all controlled items. DPSC assigns different Physical Security, Special Item and Inventory Category Codes to Schedule III, IV and V items in accordance with Public Law 91-513 as stated in DLAR 4145.11. Additionally, all transactions processed to any item are maintained in SAMMS for a period of two years.

o Nonconcur "...stock records were inaccurate..." The alleged imbalances occurred because the auditors chose, after discussing formal inventory processing/procedures with DPSC personnel, to essentially conduct warehouse counts in lieu of establishing formal inventories. Formal inventories cause the establishment of Inventory Cutoff Dates (ICODs) and generating Strike or Cutoff Date Balances in the SAMMS and DWASP systems. The Inventory Control Master File and the Inventory Document Control File are the means by which pre-inventory and post-inventory infloat documents are controlled. The Mechanicsburg depot also confirms that the auditors did conduct warehouse counts instead of control inventories and Distribution Depot Susquehanna, PA (DDSP) found the alleged variances were due to infloat transactions not being properly accounted for by the auditors.

The auditors state that "variances occurred because of transactions that had been processed on the DPSC record but not on the depot records because the substances had not yet been shipped." This is a classical example of infloat DPSC used the analogy of a "check that hadn't cleared yet" to explain to the auditors the purpose of controlling infloat transactions via formal inventory. This lack of adherence to accurate inventory processing clearly invalidates the auditors sample results and projections to the controlled substance universe.

Using the auditors' data (from Appendices A and B of the draft report), and assuming the "variances" resolved through "reconciliation" were really only infloat transactions not considered during the inventory process by the auditors, more realistic accuracy levels might have been:

Record Accuracy: **81%** (113 correct/139 total)

NOT the 46.8% reported by the auditors (65 correct/139 total)

Unit Accuracy:

"Line Items With Variance" population only: **93%**
(28,849 gross qty diff/418,708 total record qty)

Estimating the total sample record qty: **96%**
(28,849 gross qty diff/786,478 est total record qty)

Dollar Value Accuracy: **95%** ($250,642 gross diff/$4,766,000 total)

The report leads the reader to the erroneous conclusion that only 47% of our inventory is accounted for. This is unbalanced reporting. 81% of our records have variances but we have accounted for 93-96% of our items and 95% of the dollar value. We strive for 100% accuracy, however we must be realistic in managing controlled items. Given that 100% accuracy is not always practical to achieve, we do employ procedures that require full investigation to include Command Security for unresolved discrepancies. Regardless, 96% unit accuracy and 95% dollar value accuracy is a far cry from the 47% "accuracy" the auditors advertise.

o Nonconcur "...unserviceable, controlled substances were dropped from accounting records before final disposition..." The report indicates a misunderstanding of the disposal process. Disposition instructions for unserviceable controlled substances are provided to the storage facility via electronic transmission of discrepancy report information and Disposal Release Orders (DRO) prior to the actual physical disposal action. The unconfirmed DRO will remain in the accountable activity's on-line files until such time as the depot confirms shipment to the DRMO. These files are subjected to mechanical followup procedures. In the depot, the custodial files will still reflect a location and open DRO until the materiel is selected and the DRO is confirmed as shipped. Accountability for materiel is transferred and/or shipped to the DRMO from the distribution activity. Should a depot fail to receive or process the disposal action, one of four processes would "flag" this discrepant situation: unconfirmed/overaged DRO followup; subsequent physical inventory; Depot Balance & Transaction Register monthly reconciliation; or the semiannual location reconciliation. Additionally, unserviceable stocks having been disposed are still "controlled" substances. When a DRO is received, the depot must hold the materiel until DRMO can arrange for proper disposal. Although it is dropped from DPSC records and the depot's inventory, it is properly picked up on DRMO's records, thus maintaining the audit trail and accountability.

o Concur. "... all losses of controlled substances in transit had not been investigated." DPSC did, for a relatively short timeframe, give credit to customers without determining the disposition of missing controlled substances. But this occurred due to an abrupt turnover in key processing personnel. DPSC corrected this deficiency in October 1991, after undergoing a division reorganization of branch responsibilities to improve operations.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101,

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 1.a: We recommend that the Director, Defense Logistics Agency, amend Defense Logistics Manual 4140.2 to require that:

o Defense Logistics Agency depots inventory controlled substances quarterly and report the results to the Defense Personnel Support Center;

o Quarterly inventories include all controlled substances regardless of condition.

DLA COMMENTS: Partially Concur. The DLAM 4140.2, as it is written and published today, does require the depots to inventory controlled substances quarterly and report the results to the DPSC. Therefore, this action is considered complete.

When an inventory is initiated, all condition codes except H and K are counted. Additionally, inventories are cancelled upon receipt of a Disposal Release Order and rescheduled after disposal action is complete. A DWASP/DDS systems change request was implemented recently that excepts Type Physical Inventory Code (TPIC) "L" inventories (Army commodity samples) from excluding H and K condition codes and from automatically cancelling inventories due to the receipt of a DRO. We will initiate action to apply this logic to all inventories involving controlled items.

DISPOSITION:
(XX) Action is ongoing. Estimated Completion Date: 30 Sep 93
( ) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
( ) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
(X) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101.

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 1.b: We recommend that the Director, Defense Logistics Agency, direct Defense Logistics Agency depots to account for controlled substances that are awaiting destruction and to provide documentation of all destruction actions to the Defense Personnel Support Center and to the Drug Enforcement Administration.

DLA COMMENTS: Nonconcur. Through existing policies, DLAR 4145.11 and DLAM 4140.2, Vol III, the Director, DLA, has directed DLA depots to account for controlled substances awaiting destruction. The applicable documentation, however, is only required to be maintained by the storing activity, the DRMO and the DEA but not by DPSC. That is because, at the point of destruction, the DRMO is accountable, not DPSC.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(XX) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101,

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 1.c: We recommend that the Director, Defense Logistics Agency, require each activity involved in managing controlled substances to identify those substances as a separate assessable unit under the internal management control program and to conduct the requisite risk assessments.

DLA COMMENTS: Nonconcur. The audit report did not identify any weaknesses for which DLA did not have a process that provided the necessary controls to ensure discrepancy identification and resolution. As such, DLA does not agree with the DoD IG audit. Our systems and interfaces provide the necessary controls required to effectively manage and accurately account for controlled substances. This position is supported by the DEA as evidenced by their March 1990 audit.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(XX) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 46102, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101,

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 2.a: We recommend that the Commander, Defense Personnel Support Center, establish and maintain separate accountable records for Schedule II controlled substances.

DLA COMMENTS: Nonconcur. Controlled substance accountable records are currently maintained in the Standard Automated Materiel Management System (SAMMS) and are readily retrievable for Schedule II items. They can be logically extracted and hard copies produced within a maximum 24 hour period. DPSC assigns different Physical Security, Special Item and Inventory Category Codes to Schedule II items in accordance with Public Law 91-513 as stated in DLAR 4145.11. All transactions processed to the accountable record are maintained by SAMMS for a period of two years.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(XX) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101,

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 2.b: We recommend that the Commander, Defense Personnel Support Center, establish and maintain accountable records that are readily retrievable for controlled substances in Schedules III, IV and V.

DLA COMMENTS: Nonconcur. Controlled substance accountable records are currently maintained in the Standard Automated Materiel Management System (SAMMS) and are readily retrievable for Schedule III, IV and V items. They can be logically extracted and hard copies produced within a maximum 24 hour period. DPSC assigns different Physical Security, Special Item and Inventory Category Codes to Schedule III, IV and V items in accordance with Public Law 91-513 as stated in DLAR 4145.11. All transactions processed to the accountable record are maintained by SAMMS for a period of two years.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(XX) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101,

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 2.c: We recommend that the Commander, Defense Personnel Support Center, maintain accountable records for all controlled substances from receipt until final disposition.

DLA COMMENTS: Nonconcur. The audit contains a basic misconception about who "owns" the materiel which was processed to disposal. Accountability is transferred from DPSC to the DRMO upon receipt of the Materiel Release Confirmation (MRC) (from the shipping depot) by DPSC. While the balance has been decremented from the National Inventory Record, DPSC maintains an unconfirmed Disposal Release Order, which is subjected to mechanical followup processing, until the MRC is received and closes out the DPSC file. Given this process, DPSC does maintain accountable records for all controlled substances from receipt until final disposition. We hereby consider this action complete.

DISPOSITION:
( ) Action is ongoing Estimated Completion Date:
(XX) Action is considered complete

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101,

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

TYPE OF REPORT: AUDIT DATE OF POSITION: 05 FEB 1993

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AUDIT TITLE AND #: Controls Over Wholesale Drug Inventories at the DLA (Project No. 1LA-0028)

RECOMMENDATION 2.d: We recommend that the Commander, Defense Personnel Support Center, research all discrepancies on shipments of controlled substances, regardless of the dollar value of the discrepancy and report losses to the Drug Enforcement Administration.

DLA COMMENTS: Nonconcur. DPSC does research discrepancies on shipments of controlled substances, regardless of dollar value, in accordance with DLAM 4140.2, and DLAM 8100.1. It is mandatory that any variation in the receipt of controlled substances, commercial or other source, be reported by the receiving activity to DPSC via a discrepancy report.

Overdue inbound shipments are identified and tracked by various SAMMS and Project ACTION reports. When discrepancies are traced to the carrier as a result of discrepancy reports or overdue shipment research, these carrier discrepancies are tracked by the SAMMS Customer Depot Complaint System.

Whenever a missing shipment transaction is processed to close a contract file, SAMMS automatically generates a mandatory research document, regardless of dollar value when the item is a controlled substance. If the adjustment remains unresolved after being subjected to causative research by DPSC personnel, DPSC will submit a Letter of Investigation to the intended recipient depot for their assistance in research. DLA Supply Operations Policy and Procedures Memorandum, No. 92-15, 1 July 1992, requires the depot to identify all unresolved adjustments on controlled items to the Command Security personnel for investigation.

The last DEA audit was conducted in March 1990, at which time they reviewed DPSC procedures, and did not cite them for not submitting formal inventory loss reports, nor did they cite any of the "accounting concerns" stated in this audit.

DISPOSITION:
( ) Action is ongoing. Estimated Completion Date:
(XX) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
(X) Nonconcur. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; however, weakness is not considered material. (Rationale must be documented and maintained with your copy of the response.)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Linda Pavlik, DLA-OWI, 77241, 12/23/92
PSE REVIEW/APPROVAL: RADM Donald E. Hickman, Executive Director, Directorate of Supply Operations, DLA-O, 46101

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
Major General, USAF
Deputy Director

Audit Team Members

William F. Thomas	Director, Readiness and Operational Support Directorate
Harrell D. Spoons	Program Director
Dianna J. Pearson	Project Manager
Glenda P. Jenkins	Team Leader
Michael L. Davitt	Team Leader
Adrienne B. Brown	Team Leader
Herbert Braun	Auditor
Susan F. Lerner	Auditor
Brian Filer	Auditor
Brenda Solbrig	Auditor
Nancy C. Cipolla	Editor
Dharam Jain	Statistician
Paula Hazlewood	Administrative Support

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Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

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