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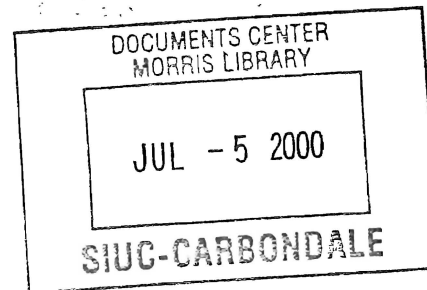
United States General Accounting Office  
Washington, DC 20548

Accounting and Information  
Management Division

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April 13, 2000

The Honorable Louis Caldera  
The Secretary of the Army



Subject: DOD Inventory: Weaknesses in Controls Over Category I Rockets

Dear Mr. Secretary:

As part of our audit of the fiscal year 1999 governmentwide financial statements, we obtained an understanding of the Army's inventory management practices and procedures for ammunition. We performed this work in coordination with the Department of Defense (DOD) Inspector General and the Army Audit Agency, which are charged with auditing the Army's financial statements. In December 1999, we identified an inventory control problem for a category I ammunition item at the Blue Grass Army Depot in Richmond, Kentucky. This problem indicated the existence of depot-specific and possible systemic internal control weaknesses. Category I ammunition items include self-contained, ready-to-fire, handheld rockets or missiles that are to be controlled by serial number and require a high level of physical security. Internal controls are intended to provide accountability and control over sensitive items and prevent the undetected loss, theft, or unauthorized use of the items. We are sending you this letter to alert you to these weaknesses and recommend actions for your immediate attention.

We initially visited the Blue Grass Army Depot during the week of December 6, 1999, to obtain an understanding of ammunition depot procedures. As part of our observation, depot officials took us to one storage igloo with category I items where we identified inventory record discrepancies. We subsequently visited the depot during the weeks of December 13, 1999, and January 18, 2000, to discuss with depot officials what actions they had taken to resolve the discrepancies. During those visits, we obtained and reviewed item shipment and receiving reports, the results of the depot's physical inventory of the rocket and launcher units, evidence of corrections made, and other documentation related to the depot's research. As part of our follow up, we also contacted officials at the Army's Industrial Operations Command (IOC),<sup>1</sup> Rock Island, Illinois, and the Army's Industrial Logistics Systems Center, Chambersburg, Pennsylvania—components of the Army Material

<sup>1</sup>On April 1, 2000, the Industrial Operations Command was renamed the Operations Support Command.

Command—to understand the item manager's role and the depot's inventory system processing of rejected receipts.

We performed our work from December 1999 through February 2000 in accordance with generally accepted government auditing standards. We requested comments on a draft of this report from the Secretary of the Army or his designee. On April 7, 2000, we received comments from officials of the Army's Office of the Deputy Chief of Staff for Logistics and the Under Secretary of Defense (Comptroller). Their comments are discussed in the "Agency Comments and Our Evaluation" section of this letter.

### **Background**

Control over sensitive category I missiles has been a long-standing problem in DOD. In September 1994, we reported<sup>2</sup> that many serious discrepancies in the quantities, locations, and serial numbers of handheld category I missiles indicated inadequate management oversight for these lethal weapons. In September 1997, we reported<sup>3</sup> that even though DOD had improved oversight of category I missiles and rockets, some weaknesses remained, including discrepancies between inventory records and our physical counts. In the 1997 report, we also pointed out that integrated accounting and logistics systems would help DOD ensure effective accountability for sensitive items because periodically reconciling accounting and logistics records would help identify any unaccounted for in-transit items associated with shipments from contractors to depots and transfers of items among depots.

### **Summary of Events**

During our visit to the Blue Grass Army Depot the week of December 6, 1999, we identified discrepancies between inventory records in the Standard Depot System (SDS)—the ammunition depot automated inventory system—and the actual number and location of on-hand quantities for a category I ammunition item. The discrepancies were discovered when we accompanied depot personnel to a storage igloo as part of our observation. This igloo contained 83-mm rocket and launcher units commonly referred to as SMAW-D (shoulder mounted assault weapon—disposable). During our initial observation, we identified discrepancies involving 425 rocket and launcher units—391 rocket and launcher units that were in the storage igloo but not recorded in SDS at all and 34 units that were recorded in SDS, but for the wrong igloo. A subsequent physical inventory of the rocket and launcher units by depot personnel revealed further discrepancies. This item was the first one counted as part of the depot's scheduled semiannual physical inventory of category I items that began the week following our initial visit. Specifically, the inventory identified an additional 376 units that were recorded to the wrong location, resulting in a total

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<sup>2</sup>*Inventory Management: Handheld Missiles Are Vulnerable to Theft and Undetected Losses* (GAO/NSIAD-94-100, September 16, 1994).

<sup>3</sup>*Inventory Management: Vulnerability of Sensitive Defense Material to Theft* (GAO/NSIAD-97-175, September 19, 1997).

of 410 location errors, and another 23 rocket and launcher units for a total of 414 that were not recorded in SDS at all.

Depot officials immediately began investigating the discrepancies identified during our visit. The following sequence of events relates to how the discrepancies occurred.

- In June and July 1999, the Blue Grass Army Depot received three shipments with a total of 1,334 rocket and launcher units. A depot clerk was given erroneous serial numbers to enter into SDS as part of recording the receipt of one of these shipments. The errors occurred when personnel storing the items in the igloo manually recorded the serial numbers on cards used for data entry into SDS. In this instance, a "7" was written instead of a "1" in 10 of the serial numbers. This method was used to record the serial numbers because these shipments contained more or less items than the number shown on the receiving reports (DD Form 250) that accompanied the shipments. When the number of items and serial numbers on receiving reports are not consistent with the items in the shipment, the receiving report information cannot be used as a complete source of data to be entered in the system or as a basis to reconcile any shipment discrepancies. Receiving reports are supporting documentation that accompany the bills of lading. Defense Contract Management Command<sup>4</sup> representatives accepted the items from the contractor and signed the receiving reports. The bills of lading had the quantities in each shipment but did not contain any serial numbers. Therefore, they also could not be used to verify serial numbers. The errors that were made as a result of recording data on the handwritten records were not detected until we identified the record discrepancy in December 1999.
- In October 1999, the depot received five shipments with a total of 1,938 rocket and launcher units. One of the shipments was received on October 14, 1999, and contained 391 of these units. When the receiving clerk attempted to record the receipt of this shipment, SDS rejected the entire shipment. This resulted in the 391 units that we identified during our initial visit as being omitted from SDS. According to depot officials, system edits used to validate data will cause entire shipments to be rejected when duplicate serial numbers of an item are identified. Depot staff did not follow the Blue Grass Army Depot desk procedures to review and correct the rejected transactions from the October shipment. Depot managers first became aware of the problem in December 1999 when we identified the discrepancy.
- An Industrial Logistics Systems Center official told us that SDS generally does not retain reject transactions in a reject file beyond 10 days. However, SDS maintains a control file of unrecorded receipts. The official told us that reject transactions that have not been corrected within 10 days should be represented in this file as unrecorded receipts. While the control file is accessible on demand, depot

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<sup>4</sup>Effective March 27, 2000, DOD established the Defense Contract Management Agency as a separate agency to replace the Defense Contract Management Command, which was a subordinate command under the Defense Logistics Agency.

personnel told us that they were not using this reporting capability as a control to ensure all receipts were recorded and therefore accounted for in SDS.

- In mid-November, the item manager at IOC noted a delay in recording the receipt of the October shipment after reviewing a planned delivery schedule from the Armament, Research, Development, and Engineering Center (ARDEC). Because the shipments in question involved a procurement managed by ARDEC, the project manager at ARDEC, rather than IOC, was responsible for initiating the shipments. The item manager contacted the ARDEC project manager to ask about the late delivery, and the project manager stated that the items had been shipped to the Blue Grass Army Depot. However, at the time of our inquiry in December, the item manager had not followed up with the depot to inquire whether the shipment had been received.
- During the week of December 13, 1999, following our initial visit, depot personnel counted all of the rocket and launcher units in the two igloos where they were reported as stored. They identified 376 rocket and launcher units the location of which was not accurately reflected in the SDS inventory records, in addition to the 34 items recorded to the wrong location that were identified during our visit the prior week. For all 410 units, the inventory records showed the serial numbers in a different storage igloo from where they were actually located. These location errors were corrected in early January. Depot officials were uncertain how these location errors occurred.
- In addition to the 391 units that were identified during our visit the prior week, the physical inventory also revealed 23 units physically in the storage igloos that were not on SDS inventory records. According to depot officials, the 23 units were to be transferred from the depot account in SDS to a Special Forces account in SDS. An official from the Industrial Logistics Systems Center told us that to execute this type of transfer, depot personnel are supposed to create a suspense file in SDS for the pending transfer because once the issue transaction is entered, the items will be deleted from SDS records and therefore from any owner accounts. To complete the transfer, depot personnel enter the issue transactions, and the organization receiving the intra-depot transfer is to immediately enter a receipt into SDS for the items. After the receipt is recorded, depot officials enter transactions into SDS to clear the transactions from the suspense file. However, on December 8, 1999, to execute the transfer, depot personnel entered issue transactions into SDS without creating the suspense file. Because the Special Forces group did not enter the receipt until January 12, 2000, the 23 units were not on any inventory records for 5 weeks.
- Also during the week of December 13, depot personnel again attempted to record the receipt of the 391 units but were unable to do so because several serial numbers from the October shipment duplicated the erroneous serial numbers already recorded in the system. Using the results of the physical inventory and researching the rejects, depot personnel initially identified 10 serial numbers from the October shipment that had been recorded for the earlier shipment. The

erroneous serial numbers entered in June coincidentally matched those in the October shipment. Depot personnel corrected the previous errors and then attempted to reenter the rejected serial numbers from the October shipment. However, the transactions continued to be rejected from the system. In early January, after depot personnel identified and corrected another erroneous duplicate serial number that was caused by a "0" being entered instead of a "1," the October shipment was finally recorded correctly in SDS.

The item manager told us that a procurement action is supposed to be recorded in the Commodity Command Standard System (CCSS) for a contract managed by IOC. When items are accepted from the contractor for IOC-managed contracts, CCSS status information is updated to show that the items are ready for shipment. ARDEC follows a similar process. Item managers also use CCSS to account for and manage inventory and report on ammunition balances. However, items are not recorded in CCSS as inventory until they are actually received and recorded at the depot. Consequently, accountability and visibility over the items are lost from the time the items are shipped from the contractor to the time the items are received at the depot.

In addition, the unit price for the rocket and launcher units varied significantly between the receiving report and systems data. Specifically, receiving report documentation (DD Form 250) showed a recent unit price of \$6,605 and a SDS printout showed a unit price of \$1,071. The item manager confirmed that the unit price is \$6,605 but could not explain the discrepancy in the amounts.

#### **Internal Control Weaknesses Related to Inventory Discrepancies**

GAO's *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999), issued pursuant to the Federal Managers' Financial Integrity Act, states that agency management should design and implement internal controls that provide reasonable assurance that all agency objectives are being achieved. These objectives encompass the effectiveness and efficiency of operations, the reliability of financial reporting, and compliance with laws and regulations. A subset of these objectives is the safeguarding of assets. Control activities include (1) reviews by management at the functional or activity level, (2) management of human capital, (3) controls over information processing, (4) physical control over vulnerable assets, (5) proper execution of transactions and events, and (6) accurate and timely recording of transactions and events.

Further, the Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to implement and maintain financial management systems that substantially comply with federal financial management systems requirements, applicable accounting standards, and the *U.S. Government Standard General Ledger*. The federal financial management systems requirements for inventory systems specify that an inventory system must account for in-transit items.<sup>5</sup> Specifically, the inventory system should account for items shipped (1) from contractors or vendors

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<sup>5</sup>Joint Financial Management Improvement Program, *Inventory System Requirements*, June 1995.

for which title has passed to the government, (2) from the inventory organization to another organization until receipt by the recipient, and (3) from one storage location to another storage location. Further, the Statement of Federal Financial Accounting Standards No. 3, *Accounting for Inventory and Related Property*, and DOD 7000.14-R, *Financial Management Regulation*, require that inventory be accounted for once title has passed from contractors to the government.

DOD 5100.76-M, *Physical Security of Sensitive Conventional Arms, Ammunition, and Explosives*, requires each DOD component to maintain records that will provide for continual accountability and, when applicable, requires that the records be kept by serial number. For example, category I missiles and rockets are to be serial number controlled. The policy also states that shipments of category I items shall provide a continual audit trail from shipper to consignee with advance certification of serial numbers of individual items.

Based on information about the causes of the discrepancies identified at the Blue Grass Army Depot, we identified the following internal control weaknesses that resulted in a loss of accountability and control over these category I items. Further, these control weaknesses indicate that the depot's inventory business processes for these sensitive items do not fully comply with federal accounting and systems requirements. These weaknesses involve inventory systems that are used throughout the Army Materiel Command as well as business processes that are likely to be in place to manage other sensitive items throughout the command. Therefore, we are concerned that the control weaknesses we identified may not be limited to the Blue Grass Depot.

- Serial number control of the items was lost at the time of shipment from the contractor because the serial numbers listed on the receiving reports (DD Form 250) that accompanied each shipment did not correspond to the actual items and quantities in that shipment. DD 250s are required to have, among other things, the quantity and description of items accepted by the government at the contractor's plant. Further, according to DOD 4500.9-R, *Defense Transportation Regulation*, DD 250s are to support the bill of lading and the persons providing the DD 250s are responsible for their accuracy. Since the bills of lading did not list the serial numbers for each item in the shipments, the serial numbers entered into SDS could not be verified to the documents accompanying the shipments, a key control to ensure that the system has accurate data. As a result, the 10 erroneous serial numbers recorded from the June shipment could not be verified using the DD 250 from the contractor or the bill of lading. Further, multiple copies of the same receiving report were used for five individual truck shipments of these rockets and launchers and the serial numbers recorded on the receiving report copies did not always match those of the items on the truck. For sensitive items that are serial number controlled, controls should be in place so that accountability is maintained during shipment between the contractor and the government.

- Rejected transactions were not promptly reviewed and corrected. This is an important control to ensure accountability and visibility of items and complete and accurate data for operational and financial management reporting. Further, information available in the system on rejected transactions that had not been corrected within 10 days was not reviewed. To ensure that the system contains complete and accurate data and that employees are performing required duties, managers should frequently and routinely review information on the number and age of outstanding rejected transactions. In this case, the rejected October 1999 shipment was not subject to visibility and control for about 3 months. Depot officials stated that this problem likely would have been discovered during the depot's scheduled semiannual physical inventory of category I items. However, relying primarily on semiannual physical inventories to ensure that errors in inventory records are identified and corrected increases the risk that visibility can be lost for significant periods and that theft or misuse could occur without timely detection.
- Accountability and visibility were lost for items being transferred between Army activities at the depot because depot staff did not follow procedures for establishing a suspense file in SDS. This resulted in 23 rocket and launcher units not being on any activities' inventory records for over a month. Although the transaction was a paper transfer of ownership within SDS that did not require physical movement of the items, such a transfer should be controlled under depot procedures through the creation of suspense files. Controls over in-transit materiel are important to ensure accountability of assets and accurate information for operational managers and financial reporting.
- Blue Grass Army Depot officials acknowledged that depot personnel needed more training in control procedures and SDS capabilities. For example, they told us that in researching the problems described in this letter they became aware of additional SDS capabilities related to the processing of rejected transactions, such as using the unprocessed receipt file to monitor rejected shipments.
- Not all of the items accepted from the contractor were promptly recorded in CCSS, which item managers use as an inventory and accounting system. Federal accounting standards and systems requirements require items to be recorded in the accounting records as inventory when title has passed to the government. Accordingly, when the government accepts title to and therefore receives items at contractor plants, the items should be immediately recorded in the logistical and accounting systems to ensure visibility of the items and completeness of information used for program and financial management as well as financial reporting. However, the Army Materiel Command did not have procedures to ensure that these category I items were immediately recorded in Army's inventory records when the government accepted them from the contractor.
- Although the IOC item manager followed up with the ARDEC project manager, the item manager did not contact the depot to verify receipt of the October shipment that was not entered into SDS. Complete and timely research of delays

in receiving shipments is important to ensure adequate asset accountability. Timely follow-up becomes a key mitigating control in the absence of inventory records for shipments from the contractor, as mentioned above, to help monitor and track in-transit inventory. Control over these rocket and launcher units appeared to be limited to an individual's initiative and follow-up by the item manager to ensure that the items are received.

- Differences in the rocket and launcher units' unit price had not been detected. The SDS price was not consistent with the actual costs of the items. Erroneous SDS data on unit prices impact the reliability of data used for financial management, including budgeting and financial reporting.

### **Conclusions**

We identified a number of internal control weaknesses that warrant immediate attention. The sensitive nature of the items in this case—ready-to-fire rockets—requires particularly stringent internal controls. The lack of accountability and visibility renders sensitive items vulnerable to theft or loss. Further, many of the issues appear to be systemic because they relate to the systems (SDS and CCSS) used to manage ammunition throughout the Army Materiel Command as well as business processes that are likely to be in place at other depots.

### **Recommendations**

We recommend that you direct and determine that the following immediate actions are taken to correct or mitigate the internal control weaknesses we identified in relation to the inventory discrepancies over a sensitive category I item at the Blue Grass Army Depot.

- Implement procedures to notify item managers and follow up with other appropriate parties when the serial numbers on the shipping documentation do not match the serial numbers of the items in the shipment.
- Monitor the status of rejected receipt transactions and other unprocessed receipts daily and ensure that rejects are promptly corrected and processed in accordance with existing depot desk procedures.
- Determine the reason for location errors, such as the one that occurred for the rocket and launcher units, and take corrective action.
- Confirm that existing procedures regarding the use of suspense files are followed for items changing ownership within the depot.
- Provide appropriate training on SDS and internal control procedures to inventory personnel.



In addition, we recommend that you direct and determine that the following corrective actions are taken to address the weaknesses identified at the Blue Grass Depot that could be systemic to the Army Materiel Command.

- Establish procedures in conjunction with the Defense Contract Management Agency to ensure that all purchases are recorded in inventory records upon acceptance by the government at the contractor site based on the receiving reports (DD Form 250s).
- Establish Army procedures to ensure that serial numbers of category I items are recorded on bills of lading or other documents that accompany the shipments to help maintain serial number control for all items in the shipment.
- Confirm that item managers have procedures to perform timely and complete follow-up on suspected shipment delays and verify that the procedures are followed.
- Verify that all depots have desk procedures for monitoring daily the status of rejected transactions and promptly correcting and processing rejects, and confirm that the procedures are followed.
- Determine the cause for the SDS and catalog prices not reflecting the current and actual cost of the rocket and launcher units, and whether the same condition exists for other category I items as well as other ammunition items, and consider the implementation of additional controls to prevent pricing errors or detect errors if they occur.

### **Agency Comments and Our Evaluation**

On March 1, 2000, we requested comments on a draft of this report from you or your designee. On April 7, 2000, officials from the Army's Office of the Deputy Chief of Staff for Logistics and Under Secretary of Defense (Comptroller) provided oral comments on our draft report. The officials concurred with nine of our ten recommendations. For the remaining one, the officials believed it should be broadened.

In our draft report, we recommended that the Commander of the Army Materiel Command establish Army procedures to ensure that ARDEC records all purchases in CCSS upon acceptance by the Government at the contractor site based on the receiving reports (DD Form 250). The DOD officials stated that based on their investigation of the findings in our draft report, they had determined that our finding that ARDEC had not recorded items in inventory upon acceptance from the contractor is not limited to ARDEC, but is an Army-wide problem for ammunition and explosives. The officials also indicated that accountability for inventory movements, referred to as in-transits, is a DOD-wide problem. They said that DOD and the Army have initiated efforts to address problems associated with accountability and

reporting for in-transit inventory. The officials indicated that corrective actions will likely require changes to policy, regulations, systems, and possibly contract language.

In response to these comments, we broadened our recommendation to focus on the need for the Army Materiel Command to work with the Defense Contract Management Agency to establish appropriate procedures for recording all purchases in inventory records upon acceptance by the government at the contractor site.

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The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations. You should send your statement to the Senate Committee on Governmental Affairs and the House Committee on Government Reform within 60 days of the date of this letter. You must also send a written statement to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of this letter.

We are sending copies of this letter to Wimpy D. Pybus, Director of Aviation, Munitions and War Reserves, Office of the U.S. Army Deputy Chief of Staff for Logistics; General John G. Coburn, Commander, U.S. Army Materiel Command; Colonel Robert Benson, Chief of Staff, Operations Support Command; Colonel Johnnie L. Allen, Commander, Blue Grass Army Depot; and Major General Timothy P. Malishenko, Director, Defense Contract Management Agency. Also, because these internal control weaknesses affect the financial reporting of inventory and related property, we are sending copies of this letter to the Honorable William J. Lynn III, Under Secretary of Defense (Comptroller), and the Honorable Helen T. McCoy, Assistant Secretary of the Army for Financial Management and Comptroller.

We appreciate the cooperation of your staff in promptly researching the discrepancies discussed in this letter and responding to our questions. We look forward to working with you and your staff on these issues. Please contact me at (202) 512-9095, or Gayle Fischer at (202) 512-9577, if you or your staff have any questions concerning this letter. Key contributors to this assignment were Alan Steiner, Keith McDaniel, William Bricking, and Donald Lentz.

Sincerely yours,



Lisa G. Jacobson  
Director, Defense Audits

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