

## APPENDIX III

ASSISTANT SECRETARY OF DEFENSE,  
Washington, D.C., July 21, 1967.

Mr. WILLIAM A. NEWMAN, Jr.,  
Director, Defense Division,  
General Accounting Office,  
Washington, D.C.

DEAR MR. NEWMAN: Reference is made to your letter of May 3, 1967 which forwarded for review and comment a draft report on Control of Depot Inventories in the Department of Defense (DoD) (OSD Case #2605).

The draft report is based on a limited review of the effectiveness of inventory controls in the DoD, particularly with those pertaining to the accuracy of depot inventory records, and to the degree of compliance with prescribed policy and procedural directives addressed to the maintenance of stock record accuracy.

The General Accounting Office (GAO) concluded from its review that substantive differences existed between stock record balances and the actual quantities of items in inventory. Those imbalances were generally attributable to the failure to: (1) establish and maintain accurate locator cards, (2) conduct regularly scheduled physical inventories, (3) adequately control documentation representing movement of stock during the physical inventory cycle, (4) adequately perform or validate reconciliations of the stock record with the physical inventory stock positions prior to posting adjustments, and (5) perform post-adjustment research to isolate causes for the significant discrepancies and to take appropriate corrective action.

Based on the overall conclusion that needed improvements must come through the concentration of management attention on the factors that have contributed to the present conditions, the report recommends that the Military Departments and the Defense Supply Agency (DSA) be directed to take necessary steps to achieve more positive enforcement of existing policies and procedures, and that a group be established to study the problems of inventory control in depth.

Generally, the types of deficiencies cited in the report are valid. However, actions now under way within each of the Military Services and the Defense Supply Agency should result in significant improvements.

The effectiveness of inventory controls at all levels is a matter of continuing concern to the DoD. The introduction of computers into the management system and the consequent transfer of accountable records from local control to centralized ADP equipment have introduced some new dimensions into the management process. While many cost and effectiveness advantages have been achieved as a result of these management innovations, the remote control of stocks on hand as well as specific warehouse locations, created transitional problems that always result from conceptual changes in basic procedures. Coupled with this was the advent of hostilities in Vietnam as well as the need for more highly competent personnel assigned to the inventory control task. Both of these latter factors further complicated the many transitional problems that were already apparent.

These problems were recognized, but the pressures to maintain a continuing flow of high priority essential military supplies to Vietnam often precluded the orderly process of converting from one system to another. However, each of the Military Services and DSA initiated specific programs to eliminate these deficiencies. For example, the Army initiated a six-phase program in September 1966. Three of these phases were completed by the end of December 1966 but not in sufficient time to be reflected in the draft report prepared by your staff. The major phase, which involves the establishment of new inventory procedures, will be phased in between May and October 1967. Likewise, the Navy, Air Force and DSA are in the process of installing new procedures which are aimed at more accurate inventory control.

The draft report recommends that the Secretary of Defense take necessary steps to direct the Military Departments and DSA to concentrate management attention on the factors that have contributed to the present conditions and to achieve more positive enforcement of existing policies and procedures. The Military Departments and DSA are now doing this and it is anticipated that current management actions will effectively reduce the problems associated with maintaining accurate physical inventories. This office will continue to review the progress being made under the programs now under way to assure the