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DEPARTMENT OF DEFENSE

# AUDIT REPORT

STOCK MANAGEMENT AT THE NATIONAL SECURITY AGENCY

No. 90-052

March 30, 1990

*Office of the  
Inspector General*



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INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
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March 30, 1990

MEMORANDUM FOR DIRECTOR, NATIONAL SECURITY AGENCY/CHIEF, CENTRAL  
SECURITY SERVICE

SUBJECT: Audit Report on Stock Management at the National  
Security Agency (Report No. 90-052)

This is our final report on the Audit of Stock Management at the National Security Agency (the Agency). The audit was made from August 1988 through May 1989 and included reviews of records and financial statements related to stock management. The overall objective was to determine if the Agency's stock management functions were performed in an efficient and effective manner. Specific audit objectives included evaluating stockage justifications, inventory controls, issue and turn-in procedures, financial management, and the adequacy of applicable internal controls. We reviewed justifications for the expansion of the Agency's NSA: (b)(3) As of September 30, 1988, there were approximately 200,000 line items, valued at approximately NSA: (b)(3) million, in stock at the Agency and its field sites.

We concluded that supply operations at the Agency did not impact adversely on operational effectiveness. Parts needed to repair and maintain Agency equipment were available when needed. Stock management procedures in effect at Agency field sites were effective in the management and control of the NSA: (b)(3) million of inventories on hand. However, improvements were needed in the management and control of supplies maintained in the Stock Fund and at Agency elements located at the Agency's Headquarters complex. We also determined that Stock Fund cash balances were not effectively managed. Regarding the Agency's plans to expand overseas support facilities, it is our opinion that sufficient justifications had not been prepared. The results of the audit are summarized in the following paragraphs, and the details, audit recommendations, and management comments are in Part II of this report.

Management oversight and internal controls over inventories maintained at the Agency Headquarters were not sufficient. Consequently, the Agency had an unnecessary investment in stock valued at NSA: (b)(3) million and in expired stock on hand valued at NSA: (b)(3) million. In addition, inventory adjustments were not researched and reported to management by responsible personnel. We recommended establishment and implementation of procedures to improve stock management at the Stock Fund and at user organizations. We also recommended consolidation of inventories and establishment of internal controls to ensure that access to stock is limited and that all inventory adjustments are researched and reported (page 3).

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The Agency had maintained excess stock fund cash on hand during 4 of the last 5 years. The excess cash was generated because the surcharge added to Stock Fund sales exceeded actual expenses. We recommended that the Agency establish procedures to perform monthly reviews of Stock Fund cash, recompute and adjust the surcharge, and return <sup>NSA (b)(3)</sup> million excess cash to the Defense Logistics Agency (page 19).

The Agency had not performed a sufficient analysis of expected benefits to be derived from the planned expansion of the <sup>NSA: (b)(3)</sup> <sup>NSA (b)(3)</sup>. As a result, the Agency's planned expenditures of <sup>NSA (b)(3)</sup> million through FY 1995 were not justified. We recommended the Agency postpone its decision to expand the facilities until additional supporting documentation is developed (page 25).

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. Controls were not established or effective to prevent unnecessary accumulation of stock and cash, to manage shelf-life items, and to safeguard inventories. Recommendations A.1., A.2., A.5., A.8., A.9., A.10., A.12., A.13., A.14., and B.1. in this report, if implemented, will correct the weaknesses. We recommended that the Agency report the problems in its annual assurance statement.

A draft of this report was provided to the National Security Agency on October 31, 1989. Comments on the draft report were received on February 5, 1990. Management comments are summarized in Part II of the report after each finding. A complete text of management comments is included in Appendix A.

The Agency agreed with Recommendations A.1., A.2., A.3., A.4., A.6., A.7., A.8., A.11., A.12., A.14., A.15., B.1., and C. Planned corrective actions for these recommendations comply with the provisions of DoD Directive 7650.3. However, estimated completion dates for the actions in Recommendations A.6. and A.11. are not sufficiently responsive for the reasons cited in Part II of this report. The Agency did not provide a date when the actions undertaken in response to Recommendation A.12. would be completed.

The Agency disagreed with fully implementing Recommendations A.5. and A.9. regarding the consolidation of bench stocks and the monitoring of bench stock management. For the reasons provided in Part II of the report, we feel that those recommendations are still warranted. The Agency also felt that limiting access to bench stocks, as proposed in Recommendation A.10., would not be cost-effective. We maintain that this recommendation should be implemented for the reasons discussed in Part II of this report.



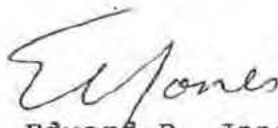
The Agency disagreed with Recommendation A.13. to use receiving reports and issue documents to research inventory discrepancies because of the problems inherent in maintaining hard copy files of issue documents. However, the Agency indicated that it would increase its automated filing capability of issue documents through implementation of bar coding procedures. We feel this action satisfies the intent of the recommendation.

The Agency also disagreed with Recommendation B.2. to return excess cash to the Defense Logistics Agency. The Agency felt that because of abnormally high accounts payable, returning excess cash would not be appropriate. The Agency indicated it was making a forceful effort to reduce its accounts payable, which would cause its cash balance to be reduced to appropriate levels. Specific actions and completion time frames were not provided. We feel that Recommendation B.2. is still valid for the reasons discussed in Part II of this report.

The Agency disagreed with the amount of monetary benefits resulting from Recommendation C. We believe that the benefits are still valid for the reasons discussed in Part II of the report. Therefore, we ask that management reconsider its position on the estimated monetary benefits of NSA: (b)(3) million, identified in Appendix B, and provide comments in response to this final report. Potential monetary benefits are subject to resolution in the event of nonconcurrence or failure to comment.

DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of the final report. Accordingly, comments on Recommendations A.5., A.6., A.9., A.10., A.11., A.12., A.13., B.2., and the monetary benefits pertaining to Recommendation C., as discussed in the paragraphs above, should be provided within 60 days of the date of this memorandum.

The courtesies and cooperation extended to the audit staff are appreciated. Audit team members are listed in Appendix D. If you have any questions pertaining to this audit, please contact NSA: (b)(3) or NSA: (b)(3). Copies of this report are being provided to the activities listed in Appendix E.

  
Edward R. Jones  
Deputy Assistant Inspector General  
for Auditing

Enclosure

cc:  
Director, Defense Logistics Agency



STOCK MANAGEMENT AT THE NATIONAL SECURITY AGENCY

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Prepared by:  
Readiness and Operational  
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STOCK MANAGEMENT AT THE NATIONAL SECURITY AGENCY

PART I - INTRODUCTION

Background

The National Security Agency (the Agency) is responsible for signals intelligence, communications security, and computer security in the DoD. To support the Agency's logistics requirements, a retail division of the Defense Stock Fund was established at the Agency in 1968. The Stock Fund maintains an inventory of parts and supplies that are issued to users when needed. The Installations and Logistics Organization is responsible for managing the Stock Fund. Policies and procedures for performing supply functions at the Agency were established in Agency Manual 60-1, "NSA/CSS Logistics Manual," dated July 1988.

Agency elements that operate repair and maintenance facilities are authorized to establish a bench stock of supplies. Bench stock consists of items that, because of repetitive consumption, are moved from the supply warehouse to their point of use in advance of actual need. Agency Manual 60-1 requires bench stock to be controlled by Agency elements.

Objectives and Scope

The objective of the audit was to determine if the stock management function was being performed in an efficient and effective manner. As of September 30, 1988, there were approximately 200,000 line items, valued at about NSA: (b)(3) million, in stock at the Agency. We focused on an evaluation of stockage justifications, inventory controls, stock issue and turn-in procedures, financial management, and applicable internal controls. We also reviewed a proposal to expand overseas support facilities at an estimated cost of NSA: (b)(3) million.

We used statistical sampling during our reviews of stockage justification and controls over Stock Fund and bench stock inventories. We tested Stock Fund usage and inventory controls by randomly selecting a stratified sample of 150 items (valued at NSA: (b)(3)) from the 37,365 line items (valued at NSA: (b)(3) million) in the Stock Fund on October 5, 1988. In reviewing bench stock items, we used a stratified sample of 337 items (valued at NSA: (b)(3)) randomly selected from the 76,946 bench stock line items (valued at NSA: (b)(3) million). Items included in our sample were stocked at 9 of the 40 activities with bench stock. Activities reviewed were randomly selected. We also used statistical sampling to evaluate stock management at field sites. A sample of 320 items (valued at NSA: (b)(3)) was selected from the 83,596 items (valued at NSA: (b)(3) million) at the field sites.



We also used statistical sampling to evaluate the management of shelf-life items. We randomly selected 90 items (valued at NSA: (b)(3)) of the 1,126 shelf-life items (valued at NSA: (b)(3) million) as of May 3, 1989. The 1,126 shelf-life items were included in the 37,365 total line items in the Stock Fund.

Our evaluation of the Stock Fund and bench stock samples included analyses of stock usage recorded in the Agency's automated inventory management system NSA: (b)(3) for a period starting 2 years prior to the date we selected our samples. In addition, we reviewed Stock Fund financial statements for FY 1985 through FY 1989 (as of April 30, 1989). We interviewed Agency Stock Fund customers and Agency officials responsible for stock management. The records at one of the nine activities selected for review, the Maintenance Management Division, were not in condition to be audited.

We made the audit from August 1988 through May 1989 and examined controls and procedures that existed as of September 1988. Material internal control weaknesses over the control and management of inventories were identified. 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. A list of the activities visited or contacted during the audit is included as Appendix C.

#### Prior Audit Coverage

The Office of the Assistant Inspector General for Auditing issued Report No. 88-080, "Management of Small Computers at the National Security Agency," on February 1, 1988. The report indicated that reviews of bench stock for small computers had not been performed to determine if the stock was still needed. The Agency concurred with the recommendation to conduct annual usage reviews of its small computer bench stock inventories and implemented corrective action. We identified similar conditions regarding the performance of usage reviews for other bench stock items during this audit, and these conditions are included in this audit as repeat findings.

There has been no General Accounting Office coverage of Stock Management within the last 5 years.



PART II - FINDINGS AND RECOMMENDATIONS

A. Supply Management

FINDING

Stock maintained to support the National Security Agency (the Agency) operations was not sufficiently managed or adequately controlled. Logistical procedures relating to initial stockage, retention, and inventory controls either had not been established or were not properly implemented. Of the NSA: (b)(3) million in stock maintained at the Agency Headquarters, we projected that stock valued at NSA: (b)(3) million was unneeded and that stock valued at NSA: (b)(3) million was no longer usable because its shelf life had expired. In addition, stock was vulnerable to loss.

DISCUSSION OF DETAILS

Background. The Materiel Management Office of the Installation and Logistics Organization is responsible for managing the Agency's Stock Fund. Policies and procedures governing the operations of the Stock Fund are contained in Agency Manual 60-1 (the Manual). Parts and supplies needed to support Agency operations are stocked by the Stock Fund and issued to users when needed. Items are stocked to support repetitive demands and to maintain insurance items. The Manual defines insurance items as "those which may be required even though there is no predictable demand, but prudence dictates that a nominal quantity be stocked, because the item is essential to the mission and the order ship time precludes satisfying the requirement as a one-time buy." The Manual also states that Agency Stock Fund users are responsible for validating and periodically substantiating the need for the continued stockage of items stocked at their request. These periodic reviews should be performed in collaboration with personnel from the Materiel Management Office. As of October 5, 1988, 37,365 items, valued at approximately NSA: (b)(3) million, were stocked in the Stock Fund.

The Agency's repair and maintenance activities are also authorized to maintain their own stock of supplies (bench stock). Bench stock consists of items that, because of repetitive consumption, are moved from the supply warehouse to the point of use in advance of actual needs. Bench stock is under the direct control of the user organization and is paid for by the user upon receipt. Within the Agency, the Engineering Office of the Telecommunications and Computer Services Organization, the Production and Control Office of the Information Security Organization, and the Facilities Engineering Office of the Installations and Logistics Organization maintained bench stock. Within these three offices, 39 activities stocked



76,946 line items worth approximately [NSA: (b)(3)] million. Another activity, a division of the Facilities Engineering Office, also maintained bench stock, but had not established a record of the number and value of the items it stocked.

Agency field sites are also authorized to stock supplies and repair parts to support operations. Both repetitive demand and insurance items are stocked by the sites. Stock management and accountability is the responsibility of logistics personnel at the individual sites. Inventory records are maintained centrally by the Installation and Logistics Organization in its automated Field Support System data base. As of October 24, 1988, 10 Agency field sites were stocking 83,596 items valued at [NSA: (b)(3)] million. In total, Agency activities managed approximately [NSA: (b)(3)] million of stock.

We audited supply operations at the Stock Fund; 9 of the 40 activities that maintained bench stock, and 3 of the 10 field sites.

Stock Management. We concluded that stock operations were successful in providing parts needed to maintain Agency systems at a high level of operational effectiveness. In addition, we concluded that stock maintained by Agency field sites was properly managed and controlled. However, we noted that improvements were needed in the management and control of Stock Fund and bench stock items. We found that unneeded stock was on hand and on order, that inventories were not adequately controlled, and that one activity was not maintaining records for the bench stock under its control. Details on these conditions are contained in the following paragraphs.

Stock Fund Items. Approximately [NSA: (b)(3)] million of the demand and insurance items included in the Stock Fund did not warrant continued stockage. To determine if continued stockage was warranted, we randomly selected 150 of the 37,365 line items in the Stock Fund inventory as of October 5, 1988, and analyzed each item's utilization. An analysis of our sample disclosed that 115 of the 150 items were stocked to meet repetitive demands and that the remaining 35 items were stocked as insurance items. Of the [NSA: (b)(3)] million of stock included in the Stock Fund, we projected that [NSA: (b)(3)] million represented demand-based stock and [NSA: (b)(3)] million represented insurance stock.

One of the criteria that the Materiel Management Office is to use to determine if demand items are excess is to identify items that have not had usage in the prior 2 years. In our sample, 31 of the 115 demand items had no usage in the last 2 years. Further, 7 of these 31 items had no usage for nearly 4 years. We provided our results to stock managers and customers, and they confirmed



that these items were no longer needed. We projected that approximately NSA (b)(3) million of the demand-based stock on hand was unneeded. In addition to the items that had no usage, 19 items in our sample had stockage levels in excess of 2 years' usage. We projected that an additional NSA (b)(3) million of stock on hand was excess to requirements.

Of the 35 insurance items included in our sample, 10 were not needed by Agency customers. We based this conclusion on discussions with the customers who had originated the requirements. In 8 of the 10 cases, the equipment supported by the items was no longer in use at the Agency. We provided managers with the results of our analysis, and they agreed with our conclusion for all 10 items. We projected that NSA (b)(3) million of the NSA (b)(3) million of stock held as insurance items was unneeded.

The method used to determine initial levels of stockage contributed to the accumulation of unneeded or excess items in the Stock Fund. Materiel Management Office personnel placed too much reliance on the customers' usage estimates. We talked to the customers who initiated requests and found that, in most cases, customers overestimated usage. Stock managers were reluctant to use their logistical judgment in setting more realistic requirements, because they did not want to affect the operational readiness of the requesting organizations.

Before our audit, the Agency had not performed periodic revalidations of requirements and usage to identify unneeded or excess stock. Action needed to identify unneeded or excess stock had not been initiated because the Agency did not have the capability to electronically request disposition instructions from the appropriate DoD inventory manager for items no longer needed. Consequently, items identified as excess were sent to the Defense Reutilization and Marketing Office (DRMO). Because the Agency does not receive credit for items disposed of through the DRMO, there was no incentive to identify and dispose of unneeded stock. If the Agency's NSA (b)(3) system was modified to allow disposition instructions to be requested electronically, Agency personnel would have an incentive to identify and dispose of excess items for credit. We believe unneeded items should be identified and reported for utilization by other DoD Components. During our audit, Materiel Management Office personnel initiated action to identify and report unneeded items.

Bench Stock Items. Approximately NSA (b)(3) million of the NSA (b)(3) million of bench stock maintained by consumer organizations did not warrant continued stockage. To review stockage of bench stock items, we statistically selected 9 activities and 337 line items for review. Of the 337 items we sampled, 184 were stocked



by consumer organizations as insurance items, a practice contrary to the provisions of Agency Manual 60-1. The Manual states that "insurance items may be required because they are mission essential even though there is no predictable demand." Because these items had no predictable demand, they did not meet the daily or weekly consumption criteria established for bench stock. Therefore, we considered the items unneeded. We projected that items in bench stock inventory valued at approximately NSA (b)(3) million were not justified.

We provided the results of our analysis to the Agency, and managers agreed that they no longer needed 73 of the 184 line items we identified. Managers wanted to retain the 111 remaining items to protect against system outages if parts failed. However, managers were unable to provide specific justification for retaining these parts. Centrally stocking insurance items in the Stock Fund, rather than in bench stock, would not seriously affect operational readiness. Parts could be issued when needed, and consumer funds would not be expended to carry the items in bench stock inventory. Also, if placed in the Stock Fund the items would be available for issue to all Agency activities, should a need arise.

Our analysis of the usage of the bench stock items that met stockage criteria disclosed that excessive quantities were on hand for 15 of the 153 items. A summary of our analysis was provided to the Agency during our audit. We projected that approximately NSA (b)(3) million of stock was excess and should be turned in to the Stock Fund. We considered an item to be excess if more than a 2-year supply of the item was available. In an extreme case, one activity stocked an item costing NSA (b)(3), which was used approximately 14 times per month. The activity had 9,234 of these items on hand, a 54-year excess supply.

To determine if the unneeded or excess parts included in bench stock could be used by other Agency activities, we reviewed Stock Fund and bench stock usage information in the NSA (b)(3) and the Maintenance Support System data bases. Of the 199 items listed in the data bases, 55 had been used during the last 2 years by other Agency activities. We projected that 2,914 line items, valued at approximately NSA (b)(3) million, could have been used by other Agency activities if the parts had been available in the Stock Fund. We also determined that the Agency had additional quantities on order for 5 of the 199 items. We projected that NSA (b)(3) million of unneeded stock was on order.

Because review procedures had not been established, unneeded or excess bench stock was not identified. Therefore, managers were not reviewing stock usage data to determine if there was a continuing need for the item and if stockage levels were



appropriate. Only one of the nine activities reviewed utilized a parts usage report. The accumulation of unneeded or excess bench stock could also be attributed to the lack of central responsibility for monitoring bench stock items. Stock was managed by the individual activities. Internal controls over bench stock inventories could be improved if each Agency element monitored its individual activities to ensure that they review usage records on an annual basis and justify the continued stockage of items with minimal or no use. Systemic problems could also be more readily identified and corrected.

The Office of the Assistant Inspector General for Auditing Report No. 88-080, "Management of Small Computers at the National Security Agency," February 1, 1988, identified problems with the Engineering Office of the Telecommunications Organization's management of its bench stock of repair parts for small computers. We met with management personnel from the Engineering Office to determine if the corrective actions taken in response to the audit were applied to all of its bench stock. Management said that the corrective actions were taken for the small computer bench stock only. If management of bench stock inventories had been centrally monitored, the recommendations in the report regarding small computer bench stock could have been applied throughout the Telecommunications Organization prior to our audit.

Shelf-Life Items. Policies and procedures for management of shelf-life items are contained in DoD Instruction 4140.27, "Identification, Control, and Utilization of Shelf-Life Items," dated June 4, 1984. Shelf-life items at the Agency consisted primarily of printing and photographic supplies and chemicals. To determine if shelf-life items were being effectively managed, we statistically selected a sample of 90 of the 1,126 shelf-life items included in the inventory as of May 3, 1989. We provided a detailed listing of our sample results to the Agency at the completion of our field work. We found that the inventories for 26 of the 90 shelf-life items sampled contained stock with expired shelf-life. We projected that NSA (b)(3) million of NSA (b)(3) million of stock being controlled as shelf-life items had expired.

We were unable to determine the dates of expiration for 22 of the 90 items in our sample, because the manufacturers did not indicate the expiration dates on the packaging. Because expiration dates were not included on the packaging, warehouse personnel could not tell whether or not they had received expired stock. Similarly, customers could not tell whether they had been issued stock that was no longer usable. Expiration dates were not shown on packaging because contracts issued by the Agency did not require the manufacturers to indicate the expiration dates.



We did not include the 22 items without expiration dates in our projection of the amount of expired stock on hand.

Warehouse personnel were not issuing the oldest stock first. Consequently, older stock remained in storage longer, increasing the chance that it would expire before issuance. This condition occurred because stock with different expiration dates was not segregated. Of the 90 items we sampled, 19 had various expiration dates, but were not separated. Further, there were no established procedures to identify and rotate stock. Aging reports were not prepared and distributed to stock managers and warehouse personnel. These aging reports would have alerted logistics personnel of stock that was approaching its expiration date, and the stock could have been issued to Agency customers or returned to the DoD supply system for reutilization.

The expiration dates entered in the NSA: (b)(3) data base were wrong or missing for 42 of the 90 items we sampled. The expiration dates in the NSA: (b)(3) were incorrect because they were computed by adding the item's useful life to the date the item was received rather than adding the useful life to the date of manufacture. The date received was used because dates of manufacture frequently were not indicated on the packaging. Without accurate information in the NSA: (b)(3) the Materiel Management Office could not adequately manage stock that was approaching its expiration date.

Of the 90 items we sampled, 14 were being controlled as shelf-life items even though they were nonperishable items. These items included lead pencils, pads of paper, and magnetic tape heads. We projected that the value of these items was NSA: (b)(3) million. Controlling nonperishable items wasted resources that could have been better utilized to control and manage perishable goods.

Stock Control. We inventoried the Stock Fund and bench stock items included in our sample and compared our results to the balances reflected on accountable records. A detailed list of our sample results was provided to the Agency at the conclusion of our field work. We found that 51 of the 150 Stock Fund balances and 103 of the 337 bench stock balances were inaccurate. We projected that 14,666 of the 37,365 Stock Fund item balances were inaccurate, and 19,101 of the 76,946 bench stock balances were inaccurate. We also projected that the combined inventory balances of NSA: (b)(3) million were overstated by NSA: (b)(3) million and understated by NSA: (b)(3) million. Materiel Management Office personnel were aware of inaccuracies in Stock Fund inventory balances, as evidenced by the 9,695 line items that experienced inventory adjustments during FY 1988. Personnel within the two organizations that maintained bench stock included in our



audit were not aware of the extent of the inventory discrepancies. We identified management and control weaknesses over inventories that needed improvement at all activities we audited.

Stock Fund Inventory Controls. The Materiel Management Office had established procedures for researching inventory discrepancies that caused balances to be adjusted. Research into causes for adjustments is the responsibility of the Office's Stock Accounting Branch. Generally, only adjustments with values exceeding NSA (b)(3) were researched. An Inventory Adjustment Register was prepared for each discrepancy showing the quantity and value of the adjustment and the cause of the discrepancy. Stock Accounting Branch reports indicated that (during FY 1988) 1,161 of 9,695 inventory adjustments required research. Documentation for only 282 of the 1,161 inventory adjustments was available. We found that 85 of the 282 adjustments were caused by stock relocation discrepancies. Further, reviews of warehouse operations disclosed that there were no formal procedures or forms for warehouse personnel to use to report stock that had been relocated. We observed that when warehouse personnel relocated stock, the relocation was recorded on pieces of scrap paper rather than on the stock relocation forms that were available. The scrap paper had to be used by clerical personnel to update the records. We believe that some of the scrap paper was lost and that the use of scrap paper instead of the formal stock relocation forms was a major cause of the inaccurate stock locations. Because stock locations were inaccurate, inventory discrepancies occurred, unnecessary research was required, and time was wasted locating stock.

Improvements were needed in the way discrepancies were researched. When an Inventory Adjustment Register was produced, the Stock Accounting Branch of the Materiel Management Office conducted research to identify the cause of the discrepancy. Each completed Register lists the item being researched, the item's transaction history, and the conclusion based on the research conducted. Personnel were providing conclusions without conducting sufficient research. The personnel who researched discrepancies placed too much dependence on information in the NSA: (b)(3) file of transaction history. Personnel were not reconciling discrepancies to hard copy documentation and were not reviewing actual receiving reports and issue documents to resolve discrepancies.

Not all discrepancies over NSA (b)(3) were researched. In FY 1986, the Chief of Supply Management decided that research into 154 discrepancies remaining at the end of the year would be impractical because research would delay initiation of the FY 1987 inventory program. As a result, the cost of all



discrepancies was combined and written off the records without further research. At the end of FY 1987, a complete wall-to-wall inventory of the Stock Fund was completed. Research to determine the reasons for discrepancies was not conducted by Stock Accounting Branch personnel. The results of the inventory were accepted as accurate because management recognized that records were incomplete and that discrepancies could not be completely researched. During FY 1988, summary reports indicated that 310 cyclic adjustments were researched. We reconciled this figure to the Inventory Adjustment Registers and concluded that 124 (40 percent) of the adjustments had not been researched as reported. Stock Accounting Branch personnel confirmed that the FY 1988 discrepancies were inaccurately reported as researched. We considered the lack of research on all required discrepancies a material internal control weakness.

Sufficient information on the causes and extent of inventory adjustments was not provided to senior managers within the Materiel Management Office. Inventory Adjustment Registers are provided to management on a monthly basis. Management personnel reviewed the causes and conclusions annotated on the report to identify any human, procedural, or system errors that could be corrected. Conclusions in the Inventory Adjustment Registers were generalized and, therefore, were not useful in identifying the specific problems that caused the discrepancies. We believe that the conclusions given for discrepancies contributed to inaccurate stock records because they did not provide managers sufficient details that could be used to spot trends and identify areas requiring corrective action. In addition, summary reports were not prepared on the causes of the adjustments. Consequently, management was further restrained from identifying areas that needed strengthening.

Two reports, the Inventory Report and the Cyclic Inventory Financial Statistics Report, that summarized the number and value of inventory adjustments did not provide sufficient information. A complete summary of adjustments to Stock Fund balances including both units and value was not provided. The Inventory Report for FY 1988 gave information on the number of items counted as part of cyclic inventories and the number of adjustments with a value of more than NSA (b)(3). The total value of the adjustments was not shown on the Inventory Report. The Cyclic Inventory Financial Statistics Report included only the number and value of adjustments that did not require research. A complete assessment of the extent of all inventory adjustments could be obtained only by combining the information on the two reports with the value of the adjustments not reported on the Inventory Report. A report reflecting the number and value of inventory

adjustments would serve not only as a performance indicator, but also as a tool for identifying and resolving problems in specific areas.

Bench Stock Inventory Controls. Internal controls had not been established to ensure proper accountability over bench stock. Procedures had not been established to require activities to perform cyclic inventories. Consequently, inventories were not performed in all activities. One manager stated that 3 years had passed since an inventory had been conducted in his activity. Some activities performed spot counts when items were issued, and if discrepancies were noted, adjusted the inventory records to agree with the physical counts. However, activities did not research why the adjustments were necessary. Further, managers were not provided reports summarizing inventory adjustments.

Access to bench stock was unrestricted. In addition to repairing items, maintenance technicians were allowed to access areas where items were stocked, to issue parts, and to update the parts data base. Maintenance technicians were allowed access to stock in seven of the nine activities we audited. In three of the seven activities, the technicians were responsible for updating the parts data base. Allowing technicians to control all key aspects of a transaction is a material internal control weakness. Separation of duties would reduce the risk of errors and the potential for fraud, waste, or abuse.

Considering the number of activities with bench stock and the number of items stocked, controlling access to these items was a major problem. For example, there were 31 activities within the Telecommunications and Computer Services Organization that stocked 53,330 line items worth approximately NSA (b)(3) million. Plans had been approved to combine 10 of the 31 activities into one central location. This action will result in the consolidation of 8,044 line items worth approximately NSA (b)(3) million. The remaining 45,286 line items are stocked by the remaining 21 activities in 26 locations in the basement and on three floors at the Agency's Headquarters building. We believe further consolidations are possible. For example, two activities were located in the same room of the basement. These activities stocked 7,669 and 2,545 line items respectively with an overall value of NSA (b)(3) million. Also, there were two activities located on the third floor. One activity stocked 1,283 line items and one activity stocked 1,945 line items with an overall value of NSA (b)(3) million. Consolidation of these and other activities would allow better control of stocked items.

Additionally, a consolidation of inventories could be accomplished within the Maintenance Management Division (the



Division) of the Installations and Logistics Organization. The Division has full or partial maintenance responsibility for ~~NSA (b)(3)~~ buildings and ~~NSA (b)(3)~~ posts. This responsibility rests with ~~NSA (b)(3)~~ Division personnel assigned to 9 maintenance shops. Stock is stored in maintenance shops, miscellaneous storerooms, and mechanical or electrical cores (equipment locations). We visited 17 locations where stock was stored and concluded that stock could be consolidated, because items stocked to support a particular shop were stored in multiple locations. For example, electrical parts were stored in five separate areas, and heating, ventilation, and air conditioning parts were stored in four separate areas. Parts consolidation would improve stock management and establish greater visibility and accountability for the stock.

Lack of Accountable Records. We were unable to audit supply operations of the Maintenance Management Division because it did not maintain any accountable records. Inventory and usage records for the Division's bench stock had not been established. The majority of the bench stock had been transferred to the Division from the General Services Administration (GSA) in October 1986 when the Agency assumed the building maintenance function. In one area where bench stock was stored, we counted 25 skids of various electrical supplies, 10 skids of lights, and 10 skids of air filters. Division personnel admitted that they had no idea of what stock was on hand. Because of this lack of internal controls, the stock within the Maintenance Management Office was susceptible to waste, abuse, and loss.

Internal Control Weaknesses. The internal control weaknesses discussed in the preceding paragraphs are material and warrant disclosure in the Agency's annual assurance statement to the Secretary of Defense on the adequacy of material management controls. These weaknesses were not included in the annual assurance letters to the Agency's Director submitted by the Deputy Director for Telecommunications and the Deputy Director for Installations and Logistics. We asked all the activities reviewed for a copy of their Internal Management Control Risk Assessments. Managers had prepared risk assessments at all the activities, but the assessments did not identify any of the inadequacies disclosed by our audit.

#### RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, National Security Agency/Chief, Central Security Service:

1. Revise Agency Manual 60-1, "NSA/CSS Logistics Manual" to require:

a. The Materiel Management Office to review customer Stock Fund requirements annually. The review process should include the supported activities' justifications of the continued need to stock the item;

b. Organizations maintaining bench stock to perform annual usage reviews and to justify the need to stock items with minimal or no usage;

c. Organizations maintaining bench stock to conduct annual physical inventories.

2. Require Stock Fund customers to provide complete justifications for placing new requirements in the system as mandated by Agency Manual 60-1.

3. Perform a one-time review of the usage of all Stock Fund and bench stock items and:

a. revalidate the need to continue to stock each item;

b. turn in unneeded bench stock to the Agency Stock Fund and unneeded Stock Fund items to the DoD supply system; and

c. cancel pending orders of items identified as unneeded. If orders cannot be canceled before receipt, place the items into the Stock Fund.

4. Transfer the Stock Fund items identified as excess during the audit to the DoD supply system.

5. Establish responsibility within the Engineering Office of the Telecommunications and Computer Services Organization and the Facilities Engineering Office of the Installation and Logistics Organization to monitor bench stock management.

6. Transfer excess bench stock identified during the audit to other users or turn in the excess to the Agency Stock Fund.

7. Perform a one-time review of all items coded as perishable and:

a. verify the need to control them as shelf-life items;

b. determine the expiration dates of all shelf-life items;

c. label the packaging of shelf-life items that do not show expiration dates;



d. update the NSA: (b)(3) data base; and

e. issue shelf-life items approaching expiration or turn in the items to the DoD supply system for reutilization.

8. Develop written policies and procedures on the management of shelf-life items to include:

a. preparation of monthly shelf-life aging schedules to be distributed to stock managers and warehouse personnel;

b. procurement requests to include a requirement that expiration dates appear on packaging; and

c. issuance of shelf-life items on a first-in-first-out basis, as required by DoD Instruction 4140.27, "Identification, Control, and Utilization of Shelf-Life Items."

9. Consolidate the number of inventory locations maintained by the Engineering Office of the Telecommunications and Computer Services Organization and the Facilities Engineering Office of the Installation and Logistics Organization.

10. Limit access to bench stock to personnel responsible for performing stock management duties.

11. Perform a one-time inventory of bench stock, research all discrepancies, and adjust or establish accountable records as necessary.

12. Establish procedures and forms for warehouse personnel to use to update stock location records when stock is relocated.

13. Use receiving reports and issue documents as well as the automated stock records to reconcile all inventory discrepancies requiring research.

14. Develop management reports that provide an overview of adjustments to Stock Fund inventory records to include the total number and value of all adjustments and summaries of the research of adjustments.

15. Report the deficiencies in the management and control of Stock Fund and bench stock inventories as a material control weakness in the Agency's annual assurance statement to the Secretary of Defense, and track the deficiencies as required by DoD Directive 5010.38.

MANAGEMENT COMMENTS

The Agency agreed with Recommendation A.1. to update NSA/CSS Logistics Manual 60-1 to require annual reviews of customers' stock requirements. The Manual will also require organizations maintaining bench stock to conduct annual physical inventories and annual usage reviews. The Manual was scheduled for revision by April 30, 1990.

Regarding Recommendation A.2., the Agency stated that procedural changes were implemented within the inventory management branch to ensure that stock request forms are properly completed. The Agency now requires the review of the forms by both the stock manager and the section supervisor.

Responding to Recommendation A.3., the Agency indicated that a review has been initiated of all items with no usage in a 2-year period. Approximately 4,000 line items valued at NSA (b)(3) million have been deleted from the Stock Fund inventory. The unneeded supplies were turned over to the Defense Marketing and Reutilization Office.

Regarding Recommendation A.4., the Agency indicated that 53 of the 97 items identified as unneeded have been excessed, and the remaining 44 will be excessed by February 16, 1990.

The Agency provided a two-part response to Recommendation A.5. The Agency indicated that the Installation and Logistics Organization plans to establish a new section to consolidate and establish control of its bench stock records. However, the Telecommunications and Computer Services Organization felt that additional oversight or monitoring will not be necessary after other recommended corrective actions are implemented.

Regarding Recommendation A.6., the Agency indicated that a team will be established to conduct physical inventories, to identify materials, and then to select items for continued storage or disposal. An October 1992 completion date was anticipated.

Responding to Recommendation A.7., the Agency indicated that management of shelf-life items had been improved. A one-time review of all shelf-life items was completed in September 1989 to ensure their proper coding. Also, shelf-life items were being reviewed for expiration, and items worth NSA: (b)(3) had been excessed. A System Change Request was submitted to modify the automated data processing system. Actions were scheduled for completion by March 1, 1990.

Regarding Recommendation A.8., the Agency indicated that actions are underway to develop written policies and procedures for



managing shelf-life items. Contract clauses are being developed, and contracts now require expiration dates to appear on all packages. Written procedures will be prepared by May 1, 1990.

Responding to Recommendation A.9., the Agency stated the Installation and Logistics Organization is taking steps to consolidate its inventory by October 1992. However, because the systems supported by the Telecommunications and Computer Service Organization are widely dispersed and the bench stock needed to support them must be located as close as possible, further consolidation was not possible.

The Agency disagreed with Recommendation A.10. to limit access to bench stock to personnel responsible for performing stock management duties. Maintenance personnel must continue to have direct access to bench stock on an around-the-clock basis. The Agency cannot afford to dedicate limited personnel resources to a single functional responsibility, particularly in a shift operation.

The Agency agreed with Recommendation A.11. to perform a one-time inventory of bench stock, to research all discrepancies, and to adjust or establish accountable records, as necessary. The inventory will be completed by October 1992.

The Agency concurred with Recommendation A.12., and noted that when the Material Tracking System (MTS) is on line, all stock relocations except turn-ins will be done by a warehouse person scanning the bar coded locations. Stock relocations will be more timely and accurate since all relocations will be recorded by bar coding scanners rather than by handwritten or typed relocation forms.

The Agency nonconcurred with Recommendation A.13. and stated that receiving reports are used as a standard procedure in helping to resolve inventory discrepancies requiring research. Issue documents will not be used because of the resources required to maintain files of issue documents. A decision has been made to automate these records through bar coding. The researchers can use the automated data to investigate discrepancies.

The Agency concurred with Recommendation A.14. and stated that three reports that reflect inventory results for management are now in place.

The Agency agreed with Recommendation A.15., and indicated that the deficiencies in the management and control of Stock Fund and bench stock inventories has been reported by the Director to the Secretary of Defense in the FY 1989 Annual Statement of Assurance. All corrective actions will be tracked to ensure that the deficiencies are corrected.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

Regarding management's response to Recommendation A.5., the implementation of other recommended, corrective actions does not negate the requirement to monitor bench stock. Our discussion on pages 6 and 7 of the finding supports the need for monitoring. Therefore, we ask that management reconsider its response to this recommendation.

Regarding the Agency's response to Recommendation A.6., a completion date of 1992 is inappropriate for the disposition of items specifically identified during the audit. Also, the 1992 completion date conflicts with the annual inventories and usage reviews that are being initiated in response to Recommendation A.1. Therefore, we request that management reconsider its time frame for completing the recommended action.

Regarding the Telecommunications and Computer Services Organization disagreement on the further consolidation of bench stock inventory locations, we maintain that Recommendation A.9. is feasible. As noted in the report, inventories belonging to various activities were located in the same room or on the same floor. Consolidating these stocks at one location per floor would not adversely impact on the availability of the repair items to maintenance personnel. We request that management reconsider its response to this recommendation.

Recommendation A.10. to limit access to bench stock to specific personnel is a needed internal control. Designation of a specific individual per shift would meet the intent of our recommendation. Therefore, we request that management reconsider its response.

The Agency's response to Recommendation A.11., to complete a one-time inventory of bench stock by October 1992, is inconsistent with the response to Recommendation A.1. to perform annual inventories. For inventories to be effective, counts must be completed and discrepancies must be reconciled within a reasonable time frame. More than 2 years to complete an inventory is an unreasonable time frame. We request that management reconsider its time frame for completing the inventory.

Although management nonconcurred with Recommendation A.13., its alternative action to use automated files of issue documents to research inventory discrepancies satisfies the intent of the recommendation. Therefore, no further response is required.



B. Financial Management

FINDING

The National Security Agency (the Agency) Stock Fund had excess cash on hand for 4 of the last 5 years. These excesses occurred because the surcharge that was added to sales exceeded actual expenditures, generating excess cash. The excess cash decreased the Agency's incentive to closely control cash and to restrict unnecessary accumulation of inventories.

DISCUSSION OF DETAILS

Background. Stock Funds were established within DoD under U.S.C., title 10, sec. 2208 to finance inventories of supplies. A Stock Fund operates as a revolving fund by acquiring inventories with funds provided at inception or received from sales to customers. Consumer appropriations, for example, Operation and Maintenance, benefit from the operation of a Stock Fund by not having to finance inventories of supplies. The Agency's Stock Fund operation began in October 1968 with an initial cash balance of NSA: (b)(3). After more than 20 years of operations, the cash balance grew to NSA: (b)(3) million as of April 30, 1989. The Agency's Stock Fund is part of the Defense Stock Fund controlled by the Defense Logistics Agency.

The Agency finances Stock Fund purchases to replenish its inventory through sales to the Agency customers. The customers' Operation and Maintenance account is charged for purchases, and Stock Fund cash is increased by a corresponding amount. Each item in the Stock Fund has an actual cost used to record obligations, accounts payable, and disbursements. However, when an item is sold, a surcharge is added to the actual cost to recover operating expenses such as inventory losses and transportation. The Stock Fund does not add a surcharge to items obtained from the Government activities, because a surcharge has already been added by the selling activity. The actual cost plus the surcharge is referred to as the standard unit price. NSA: (b)(3) the Agency's automated inventory data management system, calculates a standard unit price by averaging an item's actual cost plus the surcharge with the "old" standard unit price after each purchase.

Cash Reserve. Agency Regulation 111-30, "NSA Division of the Defense Stock Fund," assigns the Director, Finance and Accounting, the responsibility for establishing and maintaining procedures that will ensure a working cash balance compatible with both regulatory and realistic requirements. Specific guidance on the amount of cash reserve required is not addressed in Agency or DoD regulations. Discussions with personnel at the



Office of the Deputy Comptroller (Management Systems) and the Defense Logistics Agency's Revolving Fund Budget Division disclosed that a cash reserve equivalent to 11 days of Stock Fund disbursements has been the accepted standard within DoD. The cash reserve of 11 days is computed by dividing annual cumulative disbursements by 360 days and multiplying by 11. The Agency was not using an 11-day reserve to compute a normal operating cash reserve nor was it reviewing cash balances on a monthly basis. The table below shows that the Agency had excess cash balances for 4 out of the last 5 years.

<u>Excess Cash</u>			
<u>Fiscal Year</u>	<u>Cash on Hand</u>	<u>Normal Cash</u>	<u>Excess (Shortage)</u>
1985	NSA: (b)(3)		
1986			
1987			
1988			
1989			

1/ Cumulative disbursements divided by 360 and multiplied by 11

2/ As of April 30, 1989

On May 2, 1988, the Agency's Comptroller concurred in an in-house recommendation that an 11-day cash reserve be considered the normal cash operating level for the Stock Fund. The Comptroller also concurred in a recommendation that the Stock Fund Branch of the Finance Office review the Stock Fund cash balance at the end of each month and compare it with the recommended 11-day reserve. However, the Chief of the Stock Fund Branch did not implement this decision. The Branch Chief claimed to be unaware that the Comptroller had agreed to the 11-day cash operating level and the monthly cash reviews. Memorandums documenting the decision on the 11-day cash reserve had been prepared and distributed to the Stock Fund Branch, but the Agency regulations had not been revised. A monthly analysis of cash would have alerted Agency management to an excess or shortage of cash, allowing for corrective actions, such as returning excess cash to the Defense Logistics Agency (DLA) and adjusting the surcharge, to prevent future buildups of cash.

Excessive Surcharge. There was excess cash on hand because the Agency's surcharge exceeded actual expenditures. The Stock Fund overcharged for items obtained from commercial sources. The Agency added a 3-percent surcharge to commercially acquired stock to cover inventory losses (2.8 percent) and transportation expenses (.2 percent). However, the Agency had arbitrarily



arrived at these percentages without analyzing the actual expenses being incurred. Our audit disclosed that both percentages were excessive.

We compared the surcharge for inventory losses with the expenses for actual inventory losses incurred from October 1, 1985, through April 30, 1989. As shown in the table below, the surcharge added to the cost of Stock Fund purchases was higher than needed to reimburse the Stock Fund for inventory losses.

Inventory Loss Surcharge Analysis

<u>Fiscal Year</u>	<u>Surcharge</u>	<u>Net Losses (Gains)</u> <sup>1/</sup>	<u>Difference</u>
1985	NSA: (b)(3)		
1986			
1987			
1988 <sup>2/</sup>			
1989			

<sup>1/</sup> Includes returns without credit

<sup>2/</sup> As of April 30, 1989

We also compared the transportation surcharge applied (.2 percent) with actual transportation expenses from October 1, 1985, through April 30, 1989. The table below shows that the surcharge was higher than needed to reimburse the Stock Fund for transportation expenses.

Transportation Surcharge Analysis

<u>Fiscal Year</u>	<u>Surcharge</u>	<u>Expense</u>	<u>Difference</u>
1985	NSA: (b)(3)		
1986			
1987			
1988			
1989*			

\*As of April 30, 1989

To determine the amount of surcharge to cover actual expenses in FY 1989 (as of April 30, 1989) we divided the inventory loss and transportation expense by purchases at cost. We determined that a .9 percent surcharge (.8 percent for inventory losses and

.1 percent for transportation) would have adequately covered actual expenses. During our audit, DLA requested that the Agency analyze the appropriateness of its surcharge. As a result of that analysis, the Agency's Office of Budget and Programs recommended that a surcharge rate of 1.5 percent be adopted for FY 1990.

The primary difference between the Agency's recommended surcharge of 1.5 percent and our recommended surcharge of .9 percent was that our analysis considered materiel returns from users without credit, but the Agency's did not. The Defense Logistics Agency Accounting and Finance Manual requires that materiel returns without credit be included in the surcharge computation. The Agency excluded returns without credit because it felt that returns were inordinately high and could have caused the surcharge to be understated. We believe that returns should be included. We also believe that if the recommendations for improvements in stock management contained in Finding A are implemented, the amount of returns without credit will decrease, because consumer organizations will not be purchasing unneeded stock. Without a decrease in the surcharge on items purchased from commercial sources, the Stock Fund will continue to generate excess profits.

#### RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, National Security Agency/Chief, Central Security Service:

1. Revise Agency Regulation 111-30 to require:

a. a cash reserve equal to 11 days of Stock Fund disbursements (using a 360-day year);

b. a monthly review of Stock Fund financial statements comparing cash on hand with the normal 11-day reserve to determine if cash balances require adjustment; and

c. an annual review of the surcharge with adjustments as necessary to approximate actual inventory losses (including materiel returns without credit) and transportation expenses.

2. Return cash in excess of 11 days' disbursements to the Defense Logistics Agency.

#### MANAGEMENT COMMENTS

The Agency agreed in principle with the finding. Responding to Recommendation B.1., the Agency stated that Part V, Chapter II of its Resource Management Manual now requires a monthly



determination as to the appropriateness of cash balances. The Manual will be changed to include a statement that an annual review of the surcharge will be performed and that necessary adjustments will be made.

The Agency disagreed with Recommendation B.2. to return excess cash to the Defense Logistics Agency. The Agency stated that an appraisal of the Stock Fund cash on hand determined that the high accounts payable situation is abnormal and temporary due to organizational, data processing, and personnel requirements. A forceful effort to reduce accounts payable to more reasonable levels and thereby reduce the cash position was underway. The appraisal of the cash balance in the context of total assets and liabilities indicated that returning excess cash to the Defense Logistics Agency was inappropriate.

#### AUDIT RESPONSE TO MANAGEMENT COMMENTS

We agree that the accounts payable balance of NSA: (b)(3) million as of April 30, 1989, was higher than the Agency's desired 30-day balance of NSA: (b)(3) million. We do not agree that this situation is temporary. The accounts payable balance has ranged from NSA: (b)(3) million to NSA: (b)(3) million between April 30, 1988, and January 31, 1990. Also, if the NSA: (b)(3) million in excess cash as of April 30, 1989, had been used to liquidate accounts payable to the desired NSA: (b)(3) million level, there would have been NSA: (b)(3) million excess cash remaining. Consequently, we feel that cash can be returned to the Defense Logistics Agency. We ask that management reconsider its response to Recommendation B.2. To be fully responsive, provide further details regarding the efforts to reduce accounts payable to include specific actions planned or taken with milestone dates and reductions achieved.

C. Support Facilities

FINDING

The National Security Agency (the Agency) has not sufficiently justified a need for the planned expansion of its NSA: (b)(3). The Agency had not conducted a cost and benefit analysis of the proposal, and workload studies referenced in the justification documentation prepared by the Telecommunications and Computer Services Organization were not adequately performed. Further, any benefits derived since the establishment of the interim NSA: (b)(3) have not been evaluated by responsible personnel. Therefore, the Agency had plans that may result in the unnecessary expenditure of NSA: (b)(3) million on the expansion through FY 1995.

DISCUSSION OF DETAILS

Background. The Telecommunications and Computer Services Organization (the Computer Services Organization) provides maintenance support to all telecommunications and computer-based systems operated by the Agency at its Headquarters and field activities. Overseas sites that do not have logistics support and on-site repair depend on CONUS repair and return procedures to fix certain failed parts (e.g., circuit boards, radio receivers, and computer disk drives). The field sites send their broken parts to the Repair and Return Branch, which sends the parts to various activities of the Computer Services Organization at Agency Headquarters for repair. After repair, the parts are returned to the field sites.

NSA: (b)(3)



The Computer Services Organization proposes to expand the overseas facilities to increase the types of equipment



supported. The expected cost of the expansion over 5 years is <sup>NSA: (b)(3)</sup> million. The overseas facilities will service automatic data processing, collection, and communications equipment, using the same procedures in place for small computers.

In addition to expanding the <sup>NSA: (b)(3)</sup> overseas facilities, the Computer Services Organization plans to consolidate 10 of its headquarters' activities into a Signals Intelligence (SIGINT) Service Center. Repair personnel will be consolidated into one centralized work area in an effort to reduce repair and return (turnaround) time and improve quality control and security. <sup>NSA: (b)(3)</sup>

Circular 25-5 Process. Approval for both proposals is being accomplished in accordance with Agency Circular 25-5. Circular 25-5 establishes a management review process, which uses procedures designed for systems acquisition management. Initially proposed separately, the two proposals were consolidated in a Program Management Plan (the Plan) dated February 21, 1989. The Plan is being coordinated with Agency activities. After the Plan has been coordinated, it will be reviewed by senior Agency managers who will approve, redirect, or disapprove the proposals.

Results of Audit. We reviewed the Program Management Plan and the supporting documentation. We also visited the <sup>NSA: (b)(3)</sup> field sites. Based on our review of documentation and our visits overseas, we concluded that more detailed information is needed before management can make an informed decision regarding the expansions. We also concluded that significant benefits have not been achieved by the establishment of the <sup>NSA: (b)(3)</sup>

Program Management Plan. The proposal to expand the overseas facilities implied a more in-depth analysis than the analysis that was performed. The Program Management Plan references a 1-year study of all repair items sent to Agency Headquarters from the field. The proposal notes that 95 percent of the items returned is removable parts versus complete units. Consequently, the Plan implies that there is sufficient work load to support the expansion. The use of the term "1-year study" denotes a higher level of effort than we found had been performed. When we requested information on the study, responsible personnel stated that they had performed only a cursory review of shipping documents. Statistics had not been developed or analyzed on the specific number and type of parts returned, returned parts had not been segregated by field site, turnaround times had not been calculated, and funding requested to establish increased capabilities at the Support Facilities was not supported.



We reviewed the work records of the Agency's NSA: (b)(3) field sites and found that Bad Aibling, West Germany, had returned 136 parts and Menwith Hill, United Kingdom, had returned 176 parts to Agency Headquarters in FY 1988. These numbers represented the increased work load that will be absorbed by the overseas facilities after implementation of the expansion proposal. The combined FY 1988 total of 312 parts equates to only 1.25 transactions per workday. Since these sites represent NSA: (b)(3) Agency organizations in Europe, sufficient work load may not be available to justify the expansion.

Additionally, data were not available to support the funding requested for the overseas facilities. The Plan calls for NSA: (b)(3) in procurement funds and NSA: (b)(3) in Operation and Maintenance funds to be spent each year from FY 1991 through FY 1995. However, a spending profile for the overseas facilities was not available, although one had been prepared for the SIGINT Service Center. Responsible personnel stated that specific funding information could not be provided because they did not know what they would be buying in the future. For example, the proposal stated that the overseas facilities will be stocked with "selective" removable parts for immediate shipment to the field when a failure occurs. However, a list of "selective" parts to be stocked was not available. Responsible personnel felt that since the stockage would not occur until FY 1991, they could not identify in the proposal items to be stocked. Also, personnel who prepared the Plan stated that, due to technology advances, any requirements identified would be obsolete by FY 1991. We believe that 2 years is not an unreasonable time to plan for required support based on current responsibilities, trends, and needs.

Responsible personnel also stated that the number of parts maintained at the field sites will decrease. However, at the time of the audit, the personnel were not aware of what parts and how many were stocked at the various site locations or what parts and how many would be decreased. We believe that obtaining information on the type and number of parts stocked and the number that will decrease at the field sites is necessary before requesting funding and project approval.

Cost and Benefit Analysis. The proposal states that the proposed expansion will reduce mission loss caused by out-of-service equipment as well as reduce lengthy repair times. Statistical analyses identifying the number of equipment failures that were awaiting replacement parts had not been prepared. Further, the number of days the equipment was out of service had not been computed. We found no evidence to indicate that expansion would significantly improve operational readiness. The field sites keep a substantial stock of



replacement parts on hand. Therefore, loss of mission time due to out-of-service equipment awaiting parts is minimal. Furthermore, significant reductions in turnaround time may not be achievable. Specific reductions in turnaround time had not been identified in the proposal. However, the initial documentation for the NSA: (b)(3) prepared in June 1986, noted that the establishment of the Facility would reduce turnaround time from 10 months to 1 to 2 months. Our evaluation of repair parts, sent from Menwith Hill and Bad Aibling to the Agency's Headquarters during FY 1988, disclosed that turnaround time was 5 months and not 10 months. Consequently, the potential maximum gain achievable in turnaround time is only 3 or 4 months as opposed to 8 or 9 months. The decreased turnaround time can be attributed to actions taken by the Computer Services Organization. For instance, repair backlogs awaiting processing were eliminated, and the number of vendor contracts were significantly reduced to make coordination of repair work easier. However, reducing the time it takes to restock an item has no impact on system availability and, therefore, may not justify the expansion.

Benefits from Overseas Operations. The Computer Services Organization had not performed cost and benefit analyses to evaluate the results attained from the overseas operations. We performed a limited audit of the overseas operations and concluded that significant benefits had not been achieved. Although equipment turnaround times between the Agency and the sites were shorter, no significant cost or operational benefits were identified. Although the NSA: (b)(3) had been operational for 2 years, the sites are still maintaining substantial inventories of small computer parts. For example, 111 small computer replacement parts worth NSA: (b)(3) were held at Bad Aibling. Personnel at the Bad Aibling field site knew of no plans to reduce the inventories. We concluded that improvements in operational readiness had not resulted. Although analysis of the failure rates of small computers at the sites we visited had not been performed, maintenance personnel at the sites did not consider the number of failures to be significant.

The NSA: (b)(3) work load is small. Our audit of records that were maintained showed that only 731 parts were received from supported activities for replacement during the 35-month period ended in January 1989. Of the 731 items, 280 were received from October 1988 through January 1989, after the Facility moved NSA: (b)(3). Although, the work load increased during that 4-month period, we attributed the growth to the additional number of activities supported. Even with the added work load, the statistics indicated only 3.33 parts received per workday. The Computer Services Organization needs to perform an analysis of the overseas operations to see if cost and operational benefits have been achieved.



RECOMMENDATIONS FOR CORRECTIVE ACTION

We recommend that the Director, National Security Agency/Chief, Central Security Service postpone the decision to expand the NSA: (b)(3) until sufficient information is developed. The decision should be based on an analysis by the Telecommunications and Computer Services Organization of the cost and operational benefits expected to be achieved by the expansion. Additionally, the Telecommunications and Computer Services Organization should perform an analysis of the cost and operational benefits that the interim facilities have achieved since their inception.

MANAGEMENT COMMENTS

The Agency concurred with the finding and recommendations and stated that because of the fiscal climate, all proposed expansions to the NSA: (b)(3) have been canceled. If either of the facilities is considered for expansion in the future, complete financial as well as operational analyses will be conducted. The Agency indicated that the monetary benefits attributed to this action were NSA: (b)(3) million rather than the NSA: (b)(3) million indicated in the report. The reply stated that the proposed expansion to these facilities had already been decreased to NSA: (b)(3) million before the audit.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

During the staffing of this report, managers within the Telecommunications and Computer Services Organization indicated to us that the proposed expansion cost had been reduced to NSA: (b)(3) million. However, documentation supporting the reduction was not provided. Therefore, we did not adjust the cost figures in the draft report. After receipt of the Agency's comments on the draft, documentation indicating that the funding was reduced to the NSA: (b)(3) million level was provided. The reduction was made on May 23, 1989, which was 1 month after we had issued a memorandum to the Agency on April 20, 1989, indicating our initial concerns regarding the cost of the expansion. Since the action was taken after we notified the Agency of our audit conclusions, we feel that the amount of monetary benefits claimed is appropriate.



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NATIONAL SECURITY AGENCY  
CENTRAL SECURITY SERVICE  
FORT GEORGE G MEADE MARYLAND 20755-6000



Serial: N-006-90

29 JAN 1990

MEMORANDUM FOR THE DIRECTOR, READINESS AND OPERATIONAL SUPPORT,  
OFFICE OF THE DOD IG

SUBJECT: Draft Audit Report on Stock Management at the National  
Security Agency (Project No. 8IK-0072)

Attached are NSA's comments to the subject report dated  
31 October 1989. If you have any questions, or need additional  
information, please contact NSA: (b)(3)

NSA: (b)(6)

JAMES F. ROGAN  
Comptroller

Encl:  
a/s

Section A. Supply Management

FINDING: Stock maintained to support NSA operations was not sufficiently managed or adequately controlled.

CONCUR: Although we concur with the finding and are making every effort to improve stock management, it should be noted that the ~~NSA: (b)(3)~~ and ~~NSA: (b)(3)~~ projected figures are strictly projections and true figures are not at this time known.

RECOMMENDATION 1: Revise Agency Manual 60-1, "NSA/CSS Logistics Manual" to require:

a. The Materiel Management Office to review customer Stock Fund requirements annually. The review process should include the supported activities' justification of the continued need to stock the item;

b. Organizations maintaining bench stock to perform annual usage reviews and justify the need to stock items with minimal or no usage;

c. Organizations maintaining bench stock to conduct annual physical inventories.

CONCUR. The NSA/CSS Logistics Manual will be updated by 30 April 1990 to incorporate this recommendation as follows:

a. Part II, Chapter 6-5, Para b.3 will be changed to read: (The Office of Materiel Management is responsible for). . . "Reviewing customer stock requirements annually through an automated or manual process that includes validation of justification from users for the need of continued stockage in order to prevent accumulation of excessive inventory."

b. Part II, Chapter 11-1, Para b(4) will be changed to read "Organizations maintaining bench stock must conduct both annual physical inventories and annual usage reviews. Items reviewed that do not meet the criteria for continued stockage will be returned to the Stock Fund or excessed through appropriate channels."

RECOMMENDATION 2. Require Stock Fund customers to provide complete justifications for placing new requirements in the system as mandated by Agency Manual 60-1.

CONCUR. In March 1989, procedural changes were implemented within the inventory management branch to insure that the NSA Form J5737 is properly completed before new items are placed into the NSA Stock Fund. We now require the review of the J5737 by both the stock manager and the section supervisor for completeness.

RECOMMENDATION 3. Perform a one-time review of the usage of all Stock Fund and bench stock items and:



- a. Revalidate the need to continue to stock each item;
- b. turn in unneeded bench stock to the Agency Stock Fund and unneeded Stock Fund items to the DoD supply system; and
- c. cancel pending orders of items identified as unneeded. If orders cannot be cancelled before receipt, place the items into the Stock Fund.

CONCUR. A review has been initiated of all items with no usage in a two-year period. To date we have:

-reduced the audit projection of NSA (b)(3) million in unneeded demand-based supplies by NSA (b)(3) million (69%).

-deleted approximately 4,000 line items from the Stock Fund inventory.

-the NSA (b)(3) million in unneeded supplies were turned over to the Defense Marketing and Reutilization Office (DRMO).

Our review is scheduled for completion in July 1990.

RECOMMENDATION 4. Transfer the Stock Fund items identified as excess during the audit to the DoD supply system.

CONCUR. The DOD IG team identified 97 items that should be disposed of immediately and excessed to the DoD supply system. Fifty-three of the items have been excessed; the remaining will be excessed to the DRMO by 16 February 1990.

RECOMMENDATION 5. Establish responsibility within the Engineering Office of the Telecommunications and Computer Services Organization and the Facilities Engineering Office of the Installation and Logistics Organization to monitor bench stock management.

Because this recommendation is addressed to two Organizations, we are supplying two answers:

The Installation and Logistics Organization concurs with the recommendation and plans to establish a new section to consolidate and establish control of their bench stock records.

The Telecommunications and Computer Services Organization nonconcur with the recommendation and will continue to hold appropriate managers responsible for managing bench stock. Additional oversight or monitoring will not be necessary after appropriate corrective actions recommended in other portions of the report are implemented.

RECOMMENDATION 6. Transfer excess bench stock identified during the audit to other users or turn in the excess to the Agency Stock Fund.

CONCUR. A team of Installation and Logistics Subject Matter Experts will be established to conduct physical inventories, identify materials, and then select items for continued storage or disposal. An October 1992 completion date is anticipated.

RECOMMENDATION 7. Perform a one-time review of all items coded as perishable and:

- a. verify the need to control them as shelf-life items;
- b. determine the expiration dates of all shelf-life items;
- c. label the packaging of shelf-life items that do not show expiration dates;
- d. Update the NSA: (b)(3) data base; and
- e. issue shelf-life items approaching expiration or turn in the items to the DoD supply system for reutilization.

CONCUR. Management of shelf-life items have been improved with the following actions:

a. A one-time review was completed in September 1989 of all shelf-life items to insure their proper coding as a perishable item that requires control.

b. It will be difficult to determine the manufacturing date of shelf-life items already in the stock system. The difficulty is with the inability to test shelf-life items for remaining life, and the lack of a manufacturing date to determine a remaining shelf-life. Action has been taken to correct the deficiencies noted in this report. Shelf-life items are currently being reviewed for expiration, and of the NSA: (b)(3) million potential identified by the report, NSA: (b)(3) has been excessed to date. A System Change Request (a method of modifying our ADP system to pick up a new function) was submitted to provide for locating multiple shelf-life items into one location with individual tracking of the remaining shelf-life. Completion for this action is scheduled for 1 March 1990. NSA: (b)(3) will be updated at that time.

RECOMMENDATION 8. Develop written policies and procedures on the management of shelf-life items to include:

- a. preparation of monthly shelf-life aging schedules to be distributed to stock managers and warehouse personnel;
- b. procurement requests to include a requirement that expiration dates appear on packaging; and
- c. issuance of shelf-life items on a first-in-first-out basis, as required by DoD Instruction 4140.27, "Identification, Control, and Utilization of Shelf-Life items."



CONCUR. Actions are underway to implement the above recommendation. Contract clauses are being developed for shelf-life items, and procurement requests/award documents require expiration dates to appear on all packages which will ensure material is marked with required information as well as making Receiving personnel more aware of an item with an expiration date. Written procedures will be prepared by 1 May 1990.

RECOMMENDATION 9. Consolidate the number of inventory locations maintained by the Engineering Office of the Telecommunications and Computer Services Organization and the Facilities Engineering Office of the Installation and Logistics Organization.

This recommendation is addressed to two Organizations, and we have two answers. The Installation and Logistics Organization concurs in the recommendation and is taking steps to consolidate their inventory. October 1992 is the anticipated completion date. The Telecommunications and Computer Services Organization nonconcurs in the recommendation. As stated in the draft audit report, ten locations will be consolidated in the SIGINT Service Center; however, the systems supported by the Telecommunications and Computer Service Organization are widely dispersed, and the bench stock needed to support them must be located as close to them as possible.

RECOMMENDATION 10. Limit access to bench stock to personnel responsible for performing stock management duties.

NONCONCUR. Maintenance personnel must continue to have direct access to bench stock on an around-the-clock basis. We cannot afford to dedicate limited personnel resources to a single functional responsibility, particularly in a shift operation.

RECOMMENDATION 11. Perform a one-time inventory of bench stock, research all discrepancies, and adjust or establish accountable records as necessary.

CONCUR. It is anticipated an inventory will be completed of bench stock by October 1992. At this time, plans are for Benchside Inventory Control System (BIC) terminals to be located in each storeroom to ensure accountability and usage records are maintained for use in annual reviews and justification documentation.

RECOMMENDATION 12. Establish procedures and forms for warehouse personnel to use to update stock location records when stock is relocated.

CONCUR. Two forms for stock relocations are used. These are the only forms accepted by the Data Entry Clerk for entry into the NSA: (b)(3) data base. Instances as reported in the audit of scraps of paper being used for recording stock relocations were isolated. When the Material Tracking System (MTS) comes on line, all stock relocations except turn-ins will be done by the warehouseman scanning the bar coded locations with a handheld Transaction Manager. All Transaction Managers will be uploaded daily into the NSA: (b)(3) data base. Stock relocations will be more timely and accurate since all locations will be scanned rather than handwritten or typed. An SOP for working with the MTS will be written as it becomes operational.

RECOMMENDATION 13. Use receiving reports and issue documents as well as the automated stock records to reconcile all inventory discrepancies requiring research.

NONCONCUR. Receiving reports are used as a standard procedure to help resolve inventory discrepancies requiring research. This point will be reemphasized to researchers. Automated stock records are a primary source for researching stock discrepancies and has been a standard practice before and since the implementation of NSA: (b)(3). However, NSA: (b)(3) retains on-line records for only six months, at which time the record(s) is converted to microfiche. The microfiche records are used to perform research from the last inventory that was completed. Issue documents will not be used because of the resources required to maintain those files. A decision has been made to automate this activity through bar coding. A stock item will be tracked through every step of handling until it is delivered to the customer. The customer's identification will be entered into the system as the last step. The researchers can use that data to investigate discrepancies.

RECOMMENDATION 14. Develop management reports that provide an overview of adjustments to Stock Fund inventory records to include the total number and value of all adjustments and summaries of the research of adjustments.

CONCUR. Three reports that reflect information for management are now in place. The first reporting mechanism, the Inventory Adjustment Report, addresses those stock discrepancies that require research with appropriate comments. The second report is an annual report reflecting all items counted. It is broken down into categories of items with perfect counts merely to show the inventory, items with small discrepancies not requiring research and discrepancies requiring research. All refusals for filling a customer's order are depicted by what, where, and the reason for the refusal. A third report is prepared monthly and shows all inventory postings to the record, regardless if the posting is a mirror of the record or if discrepancies exist.

RECOMMENDATION 15. Report the deficiencies in the management and control of Stock Fund and bench stock inventories as a material control weakness in the Agency's annual assurance statement to the Secretary of Defense and track the deficiencies as required by DoD Directive 5010.38.



CONCUR. The deficiencies in the management and control of stock fund and bench stock inventories has been reported by the Director to the Secretary of Defense in the FY89 Annual Statement of Assurance. All corrective actions will be tracked to ensure that the deficiencies are corrected.

Section B. Financial Management

FINDING: NSA had excess cash on hand for 4 of the last 5 years.

Concur in principle. Excess cash described in the audit report is a temporary situation, and will be corrected.

RECOMMENDATION B.1. Revise Agency Regulation 111-30 to require:

a. A cash reserve equal to 11 days of Stock Fund disbursements (using a 360-day year);

b. a monthly review of Stock Fund financial statements comparing cash on hand with the normal 11-day reserve to determine if cash balances require adjustment; and

CONCUR. NSA/CSS Regulation 111-30 has been superseded by the NSA/CSS Resources Management Manual 111-5, Part V, Chapter 11 (copy attached). Paragraph 110007, Responsibilities, satisfies the requirements of this recommendation.

c. an annual review of the surcharge with adjustments as necessary to approximate actual inventory losses (including materiel returns without credit) and transportation expenses.

CONCUR. The RMM will be changed to include a statement that an annual review of the surcharge will be conducted. Adjustments as necessary will be made in accordance with the provisions of the "Accounting and Finance Manual," Defense Logistics Manual 7000.1, Chapter 12, Section 8.

RECOMMENDATION B.2. Return cash in excess of 11 days' disbursements to the Defense Logistics Agency.

NONCONCUR. In accordance with the Resources Management Manual (RMM), the Stock Fund cash balance is reviewed at the end of each month and an analysis made of the accounts payable account to determine needed cash levels. NSA has completed an appraisal of stock fund cash on hand and determined that the currently high accounts payable situation is abnormal and temporary due to organizational, data processing, and personnel requirements. NSA is making a forceful effort to reduce the accounts payable to a more reasonable level and thereby reducing the current cash position to a more normal level. The appraisal of NSA's cash balance in the context of total assets and liabilities indicates that returning the current excess cash to the Defense Logistics Agency at this time is inappropriate.

Section C. Support Facilities

FINDING: NSA has not sufficiently justified a need for the planned expansion of its NSA: (b)(3)

CONCUR. It should be noted, however, that the auditors were advised that the proposed expansion to these facilities had already been decreased to NSA: (b)(3) prior to the audit, and that the figure of NSA: (b)(3) was no longer accurate.

RECOMMENDATION. The Director, National Security Agency/Chief, Central Security Service postpone the decision to expand the NSA: (b)(3) until sufficient information is developed. The decision should be based on an analysis by the Telecommunications and Computer Services Organization of the cost and operational benefits expected to be achieved by the expansion. Additionally, the Telecommunications and Computer Services Organization should perform an analysis of the cost and operational benefits that the interim facilities have achieved since their inception.

CONCUR. Given the current fiscal climate, all proposed expansions to the NSA: (b)(3) have been cancelled. As and if appropriate, each of the facilities may be readdressed separately in the future. If either of them are readdressed, complete financial as well as operational analyses will be conducted. As stated above, the proposed expansion to these facilities had already been decreased to NSA: (b)(3) prior to the audit, and the figure of NSA: (b)(3) was no longer accurate.



SUMMARY OF POTENTIAL MONETARY AND OTHER  
BENEFITS RESULTING FROM AUDIT

<u>Recommendation Reference</u>	<u>Description of Benefit</u>	<u>Amount and/or Type of Benefit</u>
A.1., A.2.	Internal Controls. Identify unneeded items and inventory discrepancies.	Cost Avoidance. Amount undetermined. Audit identified stock on hand that is unneeded, but could not forecast future expenditures for unneeded items.
A.3.	Economy and Efficiency. Unneeded items will be available for issue to other National Security Agency (NSA) activities, and acquisitions may be canceled.	One-time cost avoid- ance of <span style="background-color: black; color: white;">NSA (S)</span> million. Program Element 31055G
A.4.	Economy and Efficiency. Unneeded items will be available for issue.	Cost Avoidance. Amount undetermined. Audit identified unneeded stock, but could not determine if items were needed by other DoD Components.
A.5.	Internal Controls. Managers will have better oversight of stock.	Nonmonetary.
A.6.	Economy and Efficiency. Unneeded items will be available for use by other Agency activities.	One-time cost avoid- ance of <span style="background-color: black; color: white;">NSA (S)</span> million. Program Element 31055G
A.7.	Economy and Efficiency. Perishable items will be used prior to their expiration date.	Cost Avoidance. Amount undetermined. Audit identified items approaching expira- tion, but could not determine if utilization was possible.

SUMMARY OF POTENTIAL MONETARY AND OTHER  
BENEFITS RESULTING FROM AUDIT (CONTINUED)

<u>Recommendation</u>	<u>Description of Benefit</u>	<u>Amount Type of Benefit</u>
A.8.	Internal Controls. Managers will have improved oversight of perishable items.	Nonmonetary
A.9., A.10	Internal Controls. Access to inventory will be limited and improved control and oversight will result.	Nonmonetary.
A.11.	Economy and Efficiency. Inventory records will be accurate.	Nonmonetary.
A.12.	Internal Controls. Stock locations records will be accurate.	Cost Avoidance. Amount undetermined. Additional items will not be ordered
A.13.	Internal Controls. Specific causes of inventory discrepancies will be identified.	Nonmonetary.
A.14.	Internal Controls. Managers will have improved oversight of inventory adjustments.	Nonmonetary.
A.15.	Compliance with regulation or laws. Managers will recognize the significance of the control weaknesses identified during the audit.	Nonmonetary.



SUMMARY OF POTENTIAL MONETARY AND OTHER  
BENEFITS RESULTING FROM AUDIT (CONTINUED)

<u>Recommendation</u>	<u>Description of Benefit</u>	<u>Amount Type of Benefit</u>
B.1.	Internal Controls. Managers will effectively manage cash and the surcharge rate will reflect actual expense.	Nonmonetary.
B.2.	Compliance with regulation or laws. Cash in excess of requirements will be returned to the parent Stock Fund.	Nonmonetary.
C.	Economy and Efficiency Managers will be able to base their decision on valid statistical data. Savings will occur if the facilities are not expanded.	One-time cost avoidance of <span style="background-color: black; color: black;">NSA- (S)</span> million. Program Element 31055G.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Comptroller of the Department of Defense, Washington, DC

Defense Agencies

Headquarters, National Security Agency, Fort George G. Meade, MD

Headquarters, Defense Logistics Agency, Cameron Station,  
Alexandria, VA

Defense Electronics Supply Center, Dayton, OH

NSA: (b)(3)

Bad Aibling Station, Bad Aibling, West Germany

Menwith Hill Station, Harrogate, United Kingdom

Yakima Research Station, Yakima, WA



AUDIT TEAM MEMBERS

NSA: (b)(3)

NSA: (b)(3)

NSA: (b)(3)

NSA: (b)(6)

NSA: (b)(3)

NSA: (b)(6)

(b)(6), Auditor

(b)(6), Auditor

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Assistant to the Secretary of Defense (Intelligence Policy)

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Senate Committee on Armed Services  
Senate Committee on Governmental Affairs  
Senate Ranking Minority Member, Committee on Armed Services  
Senate Select Committee on Intelligence  
House Committee on Appropriations  
House Subcommittee on Defense, Committee on Appropriations  
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