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Acronyms

DLA  Defense Logistics Agency
DRMS  Defense Reutilization and Marketing Service
FLIS  Federal Logistics Information System
ICP  Inventory Control Point
MLI  Munitions List Item
April 16, 1997

MEMORANDUM FOR DEPUTY UNDER SECRETARY OF DEFENSE
(LOGISTICS)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Coding Munitions List Items (Report No. 97-130)

We are providing this report for review and comment. The overall audit was requested by the former Director, Defense Logistics Agency. This report is one in a series of reports dealing with the controls over the reutilization, transfer, donation, and sales of munitions list items. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. We request that the Deputy Under Secretary of Defense (Logistics) reconsider his position on the report’s recommendation. We request that additional comments on the report be provided by June 16, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. James L. Kornides, Audit Program Director, or Mr. Stuart D. Dunnett, Audit Project Manager, at (614) 751-1400. See Appendix E for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing
Office of the Inspector General, DoD

Report No. 97-130
(Project No. SFJ-5024.03)        April 16, 1997

Coding Munitions List Items

Executive Summary

Introduction. This is one in a series of reports resulting from our audit of the Controls Over the Reutilization, Transfer, and Donation of Munitions List Items (Project No. SFJ-5024). The Director, Defense Logistics Agency, requested the audit because he was concerned that munitions list items might be released outside DoD without proper controls. Appendix B summarizes the results of the first two reports, which concern the Navy’s management of the transfer of reclaimable aircraft to museums and Army controls over the disposition of excess helicopters and parts. A report concerning the disposal of munitions list items in the possession of Defense contractors will be issued as well.

Munitions list items are military articles that require special handling at disposal to prevent their unauthorized use by domestic or foreign purchasers. Special handling instructions are provided by means of assigning a demilitarization code to each item at the time the item is accepted into the DoD inventory. Munitions list items can range from major weapon systems (tanks) to key components (spring mechanisms in firearms) of the related weapon systems. The Military Departments control munitions list items in their possession at disposal through demilitarization or by following trade security policies. Demilitarization controls are intended to destroy or render useless the military characteristics of certain types of munitions list items, while trade security controls are designed to reduce the possibility of illegal exports of munitions list items.

Audit Objectives. The overall audit objective was to evaluate whether the Defense Reutilization and Marketing Service and the Defense Contract Management Command were appropriately reutilizing, transferring, donating, and selling munitions list items. For this part of the audit, we evaluated the adequacy of DoD demilitarization and trade security coding policies pertaining to the munitions list items the Defense Logistics Agency organizations disposed of. We also reviewed the adequacy of the Defense Logistics Agency management control program as it related to the audit objectives.

Audit Results. The policies governing the coding of munitions list items were adequate. However, DoD organizations did not follow these policies and assigned inaccurate codes to more than half of the items we reviewed. Our random statistical sample indicated that from October 1994 to May 1995, DoD Components assigned inaccurate demilitarization codes to 1,380 (52 percent) of the 2,658 randomly sampled items that required strict controls at disposal. Decentralization of the demilitarization coding process made it difficult to adequately train personnel and ensure consistent application of demilitarization policies. As a result of assigning inaccurate demilitarization codes, DoD may have incurred unnecessary demilitarization costs and sensitive military hardware may have been sold or advertised for sale without demilitarization controls. Improvements in the assignment of demilitarization codes are essential as anti-terrorism, overall security, and property management measures.
Recommendations in this report should improve the effectiveness of the controls over coding by ensuring that policies on demilitarization and trade security coding are followed. See Appendix A for a discussion of our review of the management control program and the material control weaknesses indicated by the audit.

**Summary of Recommendation.** We recommend that the Deputy Under Secretary of Defense (Logistics) assign one office the responsibility of assigning, challenging, and maintaining demilitarization codes.

**Management Comments.** The Deputy Under Secretary of Defense (Logistics) partially concurred with the recommendation, suggesting that it would be more effective if it were modified to indicate that the Deputy Under Secretary of Defense (Logistics) should give strong consideration to centralized coding during the ongoing study on overall improvement of the DoD demilitarization program. The Deputy Under Secretary of Defense (Logistics) questioned specific statements in the report. Part I contains a summary of management comments and Part III contains the complete text of management comments.

**Audit Response.** Management comments were not responsive. Decentralized management of the coding process has not been successful and drastic reengineering of the process is necessary. We believe that further study is unlikely to produce a better alternative than centralized management of the coding process.

The wording of the report was adjusted where appropriate based on management comments. We ask that the Deputy Under Secretary of Defense (Logistics) reconsider his position and provide additional comments by June 16, 1997.
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Part I - Audit Results
Audit Background

This is one in a series of reports resulting from our audit of the Controls Over the Reutilization, Transfer, and Donation of Munitions List Items (Project No. 5FJ-5024). The former Director, Defense Logistics Agency, requested the audit because he was concerned that munitions list items (MLIs) might be released outside DoD without proper controls. Appendix B summarizes the first two reports, which concern the Navy’s management of the transfer of reclaimable aircraft to museums and Army controls over the disposition of excess helicopters and parts. A report concerning the disposal of MLIs in the possession of Defense contractors will be issued as well. A future report is in draft regarding exchange transactions at the U.S. Center for Military History involving MLIs.

MLIs are military articles that require special handling at disposal to prevent their unauthorized use. MLIs can range from major weapon systems (tanks) to key components (spring mechanisms in firearms) of the related weapon systems.

Special handling instructions are provided by assigning a demilitarization code to each MLI at the time it is accepted into the DoD inventory to prevent unauthorized use by domestic or foreign purchasers at the time of disposal. MLIs in the possession of the Military Departments are controlled at disposal through demilitarization or by following trade security policies. Demilitarization controls are intended to destroy or render useless the military characteristics of certain types of MLIs, while trade security controls are designed to reduce the possibility of illegal exports of MLIs. The main distinction between the two types of controls is that demilitarization prevents the unauthorized use of military hardware, while trade security controls prevent the unauthorized export of MLIs not requiring demilitarization.

The Military Department organizations establish demilitarization controls when assigning a national stock number to an item. The demilitarization code is used to identify whether an item should be classified as an MLI and to convey the corresponding level of control required at disposal. Appendix C provides a list of the demilitarization codes.

The Defense Logistics Agency (DLA) is responsible for the disposal of MLIs. MLIs are disposed of by 184 Defense Reutilization and Marketing Service (DRMS) offices worldwide. The following overall DoD disposal goals minimize the need for abandonment or destruction of excess DoD property.

- Reutilize excess DoD property from one DoD organization to satisfy valid needs of another DoD organization. Reutilization within DoD is intended to preclude concurrent procurement and disposal. DoD does not have restrictions on the reutilization of MLIs within DoD. Organizations, such as military museums and law enforcement organizations, were eligible to obtain MLIs, including those requiring demilitarization, as a result of authorizations from Congress. However, those MLIs were subject to demilitarization and trade security controls upon final disposal.
Audit Results

- Donate and transfer excess DoD property to other Federal, State, and local organizations. There are no restrictions placed on Government organizations obtaining non-MLIs (demilitarization code A).

- Obtain optimum monetary return for excess DoD property sold.

Audit Objectives

The overall audit objective was to evaluate whether the DRMS and the Defense Contract Management Command were appropriately reutilizing, transferring, donating, and selling munitions items. Specifically, we evaluated the adequacy of DoD demilitarization and trade security coding policies pertaining to the MLIs that DLA organizations disposed of. We also reviewed the adequacy of the DLA management control program as it related to the audit objectives. See Appendix A for a discussion of the scope, methodology, and the review of the management control program. See Appendix B for a summary of prior audits and other reviews.
Assignment of Demilitarization Codes

The policies governing the coding of MLIs were adequate, and, if followed, should result in the proper disposal of MLIs through the DRMS. However, DoD organizations did not follow the policies and assigned inaccurate codes to more than half of the items (1,380 of 2,658 items) we reviewed. Policies were not followed because the coding process was too decentralized, making it difficult to train personnel and to ensure compliance with DoD policies. In addition, although DoD organizations challenged demilitarization coding, inventory control points had not responded to 93 percent of 4,522 challenges as of February 1996. Unless the response rate is improved, it would take the inventory control points 500 years to purge the system of the existing obsolete demilitarization codes assigned. As a result, items such as cannon tubes and guided missile acquisition units were sold or advertised for sale by the DRMS without demilitarization controls. Improvements are essential as anti-terrorism overall security and property management measures.

Identifying and Controlling Munitions List Items

Section 38 of the Arms Export Control Act of 1976 allows the President to restrict exports of military goods and services for national security and foreign policy purposes. Executive Order 11958 delegated the President’s statutory authority to establish export controls to the Department of State.

The Department of State, with concurrence by the DoD, identified 21 categories of weapon systems and military articles (see Appendix D) that are subject to export controls because they:

- have been specifically designed, developed, configured, adapted, or modified for a military application;
- have significant military or intelligence applicability; and
- have no predominant civil application or performance equivalent.

Code of Federal Regulations, title 22, "International Traffic in Arms Regulation," implements the Arms Export Control Act. Weapon systems and essential weapon system parts, components, and attachments in the 21 categories are called MLIs. The International Traffic in Arms Regulation defines the MLIs, specifies procedures for obtaining export licenses, and prescribes penalties for violating the Arms Export Control Act.

assign demilitarization codes to inventory and technical managers at the inventory control points (ICPs). DoD 4160.21-M-1 also provides guidance for assigning the proper code.

DoD uses demilitarization codes to identify MLIs and to convey the level of demilitarization or trade security control required at disposal. Inventory and technical managers at the military component ICPs are responsible for assigning demilitarization codes during initial provisioning or when items are purchased for supply and maintenance purposes. A demilitarization code becomes part of the item's record in the Federal Logistics Information System (FLIS). DoD designated about 20 percent of the items in the FLIS as MLIs requiring some level of control at disposal. The levels of control range from total destruction for code D MLIs to trade security controls for code B MLIs.

Defense Logistics Agency Responsibilities. DLA has primary responsibility for disposing of MLIs, updating policies pertaining to the coding process in DoD 4160.21-M-1, and managing the challenge program. The challenge program is designed to validate questionable demilitarization codes and to correct them as needed. DLA has trade security investigators to help enforce demilitarization and trade security policies.

Assignment of Demilitarization Codes

From April through October 1994, DLA evaluated the assigned demilitarization codes for 11.6 million items. As a result of the evaluation, the demilitarization codes of 3.2 million (28 percent) items were changed. However, despite the efforts to correct the erroneous demilitarization codes, DoD organizations continued to assign inaccurate demilitarization codes.

To evaluate the effectiveness of the demilitarization coding process at the military component ICPs, we took a statistical sample of 122 items from a universe of 60,607 items added to the FLIS from October 1, 1994, through May 3, 1995. The sample represented the entire universe of items added to the FLIS during the stated period that were managed by the Military Departments and DLA. The 122 items were in two groups (see Appendix A). Group I included 70 items that we did not examine extensively because they do not require strict controls. (Group I consists of demilitarization code A items, such as common hardware and demilitarization code B items, such as chemical suits.) Group II consisted of 52 MLIs that required strict controls and were assigned a code that required demilitarization.

To determine whether items were correctly coded for demilitarization, we requested that personnel with expertise from the cognizant ICPs evaluate the accuracy of the codes they assigned. The results of their analysis for the 52 items in Group II (items that require demilitarization) are shown in the figure below.
Assignment of Demilitarization Codes

<table>
<thead>
<tr>
<th>Accurate codes</th>
<th>Inaccurate codes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Demilitarization required</td>
<td>MLIs, but incorrect level of demilitarization</td>
</tr>
<tr>
<td>25 (48 percent)</td>
<td>7 (14 percent)</td>
</tr>
<tr>
<td>MLIs, but demilitarization not required</td>
<td>Not MLIs, so demilitarization not required</td>
</tr>
<tr>
<td>9 (17 percent)</td>
<td>11 (21 percent)</td>
</tr>
</tbody>
</table>

Analysis by ICP Personnel of the 52 Sample Items Requiring Demilitarization

The military component ICPs disagreed with 27 of 52 codes that were assigned to Group II. Projecting the results, we estimated that the ICPs would have disagreed with 1,380 of 2,658 (51.9 percent) Group II MLIs.

The analysis results showed that the ICPs assigned incorrect codes. Although DLA completed an extensive recoding effort in 1994, the problem of assigning incorrect codes was not corrected.

Process of Assigning Codes

Inaccurate demilitarization coding occurs because the coding process is too decentralized, making it difficult to train personnel involved in coding and to ensure that DoD policies are consistently followed. DLA estimated that more than 3,000 personnel were involved in some aspect of assigning demilitarization codes DoD-wide. All the personnel involved in the coding process had not received the specialized training needed to ensure compliance with demilitarization policies. In addition, personnel responsible for assigning codes often did not have access to information needed to select the appropriate code. As a result, ICP personnel did not comply with policy when assigning demilitarization codes.

Training Personnel Responsible for Assigning Demilitarization Codes. Item managers, equipment specialists, and provisioning personnel at the ICPs assigned demilitarization codes as part of their job function, but it was not a primary duty. Recognizing the need for trained personnel to assign proper
Assignment of Demilitarization Codes

codes, the DoD Demilitarization Program Office requested that the Army Logistics Management College develop a 1-week course on demilitarization. In FY 1995, 624 personnel, primarily from the ICPs and the DRMS, attended the course.

To assess the effectiveness of the course, we asked personnel at the sites we visited to evaluate their ability to assign demilitarization codes after being trained. The consensus was that the course provided only general awareness of the demilitarization program and did not provide the specific details necessary to make prudent decisions on selecting the appropriate codes. ICP demilitarization coordinators stated that specialized training on all aspects of the demilitarization process would be required to be able to assign a code that would ensure the appropriate level of control over final disposal.

We believe that this training effort could be minimized by centralization of the coding process. Training a small number of personnel in a central office would be more efficient than training an estimated 3,000 item managers currently responsible for the assignment of accurate demilitarization codes.

Compliance with Policy. Not all ICP personnel responsible for assigning demilitarization codes understood demilitarization policies or adapted readily to changes in those policies. Some examples follow.

- DoD issued a change to DoD 4160.21-M-1 on February 14, 1995, that reduced the number of demilitarization codes from 15 to 9. Although the policy was issued in the midst of the sample selection period, ICP personnel still assigned one or more of the six obsolete codes after the change was issued because item managers had not been informed of the change. For MLIs requiring demilitarization (MLIs other than codes A, B, or Q), in the January 1996 FLIS, 168,663 (33 percent) of the MLIs were assigned an obsolete demilitarization code.

- Personnel at the Navy ICP assigned a demilitarization code of H to national stock number 5975-01-412-3449 on April 17, 1995. They also assigned a demilitarization code of N to national stock number 2840-01-410-6740 on March 9, 1995. Both codes were obsolete as of February 14, 1995, because of issuance of Change 1 to DoD 4160.21-M-1.

Selecting Appropriate Demilitarization Codes. Decentralization affected the selection of appropriate demilitarization codes. ICP personnel responsible for assigning codes frequently assigned codes without knowing about the military capability of a weapon system or of the risk to national security interests as a result of improper release of controlled items.

Military Capability. According to DoD 4160.21-M-1, the purpose of demilitarization is to destroy the military offensive or defensive advantages inherent in certain types of equipment or material. Information about the military capability of a weapon system is needed to identify the components, parts, and accessories that are essential to operate and maintain the weapon system. Technical data about the weapon system must be available and considered before selecting a demilitarization code. Technical data are
Assignment of Demilitarization Codes

especially important as weapon systems become more advanced and as more critical technology is used in computer circuit boards, software, and other areas where it is difficult to identify lethal or sensitive capabilities.

Program management offices of major weapon system programs, such as the F-16 aircraft, Bradley Fighting Vehicle, Abrams Tank, and the Multi-Launch Rocket System, could not identify the key components that required demilitarization in those weapon systems. For example, at Wright-Patterson Air Force Base in Dayton, Ohio, personnel responsible for approving the release of F-16 parts from contractor facilities referred us to the contractor for a list of the parts requiring demilitarization. The ICP personnel from the Tank, Automotive, and Armaments Command could not provide lists of sensitive parts for the Abrams Tank or the Bradley Fighting Vehicle and stated that DLA might have such lists. However, the DLA ICPs stated that they often do not receive technical data from the Military Departments. The technical data on a particular weapon system are necessary to make an informed decision about demilitarization.

Rationale for Demilitarization Decisions. ICP personnel who assigned codes were not required to document the rationale for their decisions. ICP personnel used subjective factors to assign demilitarization codes. Three ICPs visited had incorporated default criteria in their methods of assigning demilitarization codes. Default criteria incorporate the automatic assignment of a demilitarization code based on specific data, such as Federal supply class (for example, all items in Federal supply class 5680, miscellaneous construction materials, were assigned demilitarization code A at the Defense Construction Supply Center). When the ICP used default criteria, the rationale for the assigned code was not known and the codes were likely to be challenged, because they were not based on criteria such as military capability and risk.

For example, the Defense Electronics Supply Center in Dayton, Ohio, assigned demilitarization code A or D to electronic microcircuits, depending on whether the item could be identified to a weapon system. The ICP equipment specialists responsible for assigning the demilitarization codes stated that they frequently did not know the item's end use at the time the demilitarization code was assigned. ICP personnel disagreed with the codes assigned to 9 of the 20 electronic microcircuits included in the sample of 40 items at the Defense Electronics Supply Center. The ICP personnel could not provide documentation to support the reasons for the codes assigned.

Reliance on Challenge Program

DoD organizations relied on the DoD challenge program to correct coding errors and to update obsolete codes. Although not intended for that purpose, the DRMS demilitarization challenge program was relied on as the primary means to correct obsolete and erroneous demilitarization codes.
Challenge Program. DRMS personnel receive demilitarization code challenges primarily from DRMS offices worldwide. Receiving personnel at the Defense Reutilization and Marketing Offices review the demilitarization code assigned to property. If the receiver believes the assigned demilitarization code is inaccurate, the Defense Reutilization and Marketing Office can submit a challenge to DRMS headquarters. DRMS headquarters personnel review the challenge, and if they believe that the challenge is warranted, it is submitted to the item manager at the cognizant ICP. The item manager is then responsible for authorizing any changes to the FLIS and for notifying DRMS of the decision based on the challenge.

Effectiveness of Challenge Program. The challenge program was not effective because the DRMS had not established procedures to ensure that the challenged items were evaluated by the ICPs. From December 1994 through February 1996, the DRMS forwarded 4,522 demilitarization code challenges to the ICPs. However, the ICPs provided no response for 4,192 (93 percent) of the challenge requests, and the DRMS had no procedures to follow up on them.

Other problems identified with the challenge program included the following.

- DRMS offices were reluctant to use the demilitarization challenge process because of slow responses from the ICPs.

- DoD relied on challenges to remove obsolete codes. At the FY 1995 rate of 330 challenges responded to by the ICPs per year, it would take about 500 years to purge the system of the 168,663 obsolete codes in the January 1996 FLIS.

- DLA trade security investigators stated that inaccurate demilitarization codes accounted for 95 percent of their workload and that they believed miscoding or failing to challenge items that are miscoded could represent a violation of United States Code, title 18, section 793. That law covers gathering, transmitting, or losing defense information and makes it a crime if that information willfully or through gross negligence causes injury to the United States. The investigators gave us a list of 377 items that were identified with erroneous codes. However, DRMS did not receive the list.

Effects of Miscoding. When items are properly coded, the DRMS has adequate procedures in place to ensure that proper demilitarization techniques are applied at disposal. However, when items are miscoded, there is a high probability that items will be either overdemilitarized or underdemilitarized.

Overdemilitarization. Overdemilitarization occurs when costs are incurred to demilitarize excess DoD property not requiring demilitarization. Demilitarization procedures are time consuming and often require additional costs for capital investments or for paying contractors to perform the demilitarization. In addition, because demilitarization is designed to render an item useless for its intended purpose, the item's reutilization and sales value are lessened. For example, more than 10,000 tools at a DoD contractor facility required demilitarization based on codes assigned by the system program office. The contractor estimated that it would cost about $9.5 million to demilitarize the
tools as prescribed by DoD. When presented with the estimated cost to
demilitarize the items, the system program office decided that only about 200 of
the tools actually required demilitarization.

DLA trade security investigators said that they believed personnel responsible
for miscoding items tended to require overdemilitarization because of the threat
of criminal prosecution under United States Code, title 18, section 793. However, DLA trade security investigators could not provide evidence that a
criminal prosecution had ever taken place due to miscoding. Having
documentation available to support the coding decision is the best way to ensure
that only relevant factors are considered when assigning codes.

Underdemilitarization. Underdemilitarization occurs when items
subject to control are assigned a code that does not require the appropriate
demilitarization technique. Underdemilitarization increases the likelihood that
sensitive material will be inadvertently sold or transferred from DoD control
without adequate demilitarization. Accurate demilitarization codes are essential
to prevent internal terrorist organizations and undesirable foreign countries from
obtaining sensitive material. For example, improper codes caused MLIs, such as
cannon tubes (national stock number 1010-01-246-9930), cruise missile radio
receivers (5820-01-174-8062), a radar set group (5840-00-890-6510), small
arms armor (1560-00-145-3294), a coder-decoder interface (5895-00-653-4225),
and guided missile acquisition units (1430-00-133-2540) to be sold or advertised
for sale by the DRMS without demilitarization.

Summary

Our sample indicated that more than 50 percent of the items assigned a
demilitarization code that requires demilitarization were inaccurately coded.
Because the demilitarization coding process is too decentralized, it is difficult to
train personnel and disseminate policy changes. Additionally, DoD
organizations relied heavily on an ineffective challenge process to correct coding
errors. The ICPs responded to only 7 percent of the challenges from December
1994 through February 1996. At that rate, it would take 500 years to purge the
system of all the obsolete demilitarization codes.

The DoD Demilitarization Program Office is consolidating the responsibilities
for assigning and maintaining the demilitarization codes for all items managed
by the DLA ICPs. The new consolidated office will also be responsible for the
demilitarization challenge program and for all training related to the DoD
demilitarization program. Given the failure of the existing process, we believe
that the assignment of the demilitarization code for items managed by the
Military Department ICPs should also be the responsibility of the new
consolidated office.
Recommendation, Management Comments, and Audit Response

We recommend that the Deputy Under Secretary of Defense (Logistics) consolidate the responsibility to assign, challenge, and maintain demilitarization codes into a single office; staff the office with individuals responsible for all aspects of demilitarization; and include all items managed by the Defense Logistics Agency and the Military Department inventory control points.

Management Comments. The Deputy Under Secretary of Defense (Logistics) (the Deputy) partially concurred with the recommendation. The Deputy suggested that the recommendation would be more effective if it were modified to indicate that strong consideration should be given to centralized coding in the overall improvement of the DoD Demilitarization program currently under review. The Deputy stated that he is in the process of developing an action plan addressing the overall demilitarization program, which may include establishing a working group of Federal agencies to address changes to their role in the demilitarization process and legislative changes. Although he agrees that coding consolidation may be the best approach, he also stated that other alternatives and factors must be considered. The Office of the Deputy Under Secretary of Defense (Logistics) is now implementing long- and short-term initiatives to improve the DoD demilitarization program. The Deputy also stated that several areas in the draft report did not fully support the recommendation.

Audit Response. We stand by our recommendation. Our audit and previous studies of the coding process provided compelling evidence that the current decentralized coding process has not been effective. Office of the Deputy Under Secretary of Defense (Logistics) personnel indicated, at the beginning of the audit, that they wanted the audit to make specific recommendations for improving the DoD demilitarization program and not to recommend further study or conduct another recoding exercise. We agree that establishing working groups for evaluating overall improvements in the DoD demilitarization program will be helpful in solving the various problems related to the program. However, we believe our report clearly shows that the necessary corrective measure for improving the coding problem is to centralize the process. We request that the Deputy Under Secretary of Defense (Logistics) reconsider his position and provide additional comments to the final report.
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Part II - Additional Information
Appendix A. Audit Process

Audit Scope

DoD releases munitions list items (MLIs) through public sales; through transfers and donations to Federal, State, and local activities; and through foreign military sales and assistance programs. DoD relies on the demilitarization codes assigned by the military component inventory control points (ICPs) to identify MLIs and to convey the level of demilitarization or trade security control required at disposal. To test the effectiveness of the coding process, we took a statistical sample (discussed below) of items assigned a national stock number from October 1, 1994, through May 3, 1995. We interviewed item managers at the ICPs and obtained supporting documentation for the demilitarization codes assigned. In addition, we reviewed prior audits and other reviews, evaluated results of Defense Logistics Agency (DLA) trade security investigations, talked with cognizant personnel, and reviewed selected exchange, transfer, and sales transactions.

Use of Computer-Processed Data. We used computer-processed data provided by the Defense Logistics Services Center. To the extent that we reviewed the computer-processed data, we concluded that the data were sufficiently reliable to be used in meeting our objectives. We did not audit the systems that produced the data.

Audit Period and Standards. We performed this program audit from April 1995 through February 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary.

Statistical Sampling Methodology

Sampling Purpose. The purpose of the statistical sampling plan was to determine whether the process of assigning demilitarization codes had improved since the DoD demilitarization code review effort was completed in September 1994.

Universe Represented. The universe consisted of national stock numbers in the Defense Logistics Services Center's Federal Logistics Information System that had been assigned and managed by a Military Component ICP. We sampled from a universe consisting of the following groups that were based on the demilitarization code assigned.
Appendix A. Scope and Methodology

Sampling Universe

<table>
<thead>
<tr>
<th>Demilitarization Code</th>
<th>Universe</th>
<th>Sampled</th>
<th>ICP Disagreed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group I A,B</td>
<td>57,949</td>
<td>70</td>
<td>6</td>
</tr>
<tr>
<td>Group II C,D,E,H,J,K,L,M,N</td>
<td>2,658</td>
<td>52</td>
<td>27</td>
</tr>
</tbody>
</table>

We did not examine the Group I items extensively because they do not require strict controls at disposal. We elected not to project the results of Group I.

**Sampling Design.** A stratified random sampling design was used to determine whether the demilitarization codes were assigned correctly. We selected 70 national stock numbered items from the Group I universe of 57,949 items, and we selected 52 national stock numbered items from the Group II universe of 2,658 items. We tasked the Military Component ICP personnel to evaluate the 122 sample items and determine whether they agreed with the assigned codes.

**Sample Results.** The Military Component ICPs disagreed with 27 of 52 codes originally assigned to Group II items. Projecting the results with a 95 percent confidence level, we estimated that the ICPs would have disagreed with from 995 to 1,764 of the originally assigned demilitarization codes. The point estimate for items the ICPs would have disagreed with from Group II was 1,380.

Organizations and Individuals Visited or Contacted

**Contacts During the Audit.** We visited or contacted individuals and organizations within the DoD and the Departments of State and the Treasury. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

*DoD Directive 5010.38 has been revised as "Management Control Program," August 26, 1996. The audit was performed under the April 1987 version of the directive.*
Appendix A. Scope and Methodology

Scope of Review of Management Control Program. We reviewed the management control procedures specified in DoD 4160.21-M-1, "Defense Demilitarization Manual," October 1991, regarding the assignment of demilitarization codes. We also reviewed self-evaluations of those controls that DLA originally performed in 1991.

Adequacy of Management Controls. We identified continuing material management control weaknesses, as defined by DoD Directive 5010.38, related to the assignment of inaccurate demilitarization codes. Although in the draft report we attributed those weaknesses to the DLA management control structure, after further consideration we suggest that they be characterized as a DoD-wide problem and so reported by the Deputy Under Secretary of Defense (Logistics).

Adequacy of Management's Self-Evaluation. In the DLA FY 1995 Annual Statement of Assurance, the DoD demilitarization program manager identified two material management control weaknesses related to the demilitarization program. Both control weaknesses had also been identified in prior years. The weaknesses related to the inaccurate assigning of demilitarization codes and the inadequate Military Component regulations identifying the responsibilities for the demilitarization program within the Services and DLA. The DoD has not met the target dates for planned corrective actions relating to the previously identified weaknesses, has reestablished target dates, and has not yet corrected those weaknesses.
Appendix B. Prior Audits and Other Reviews

This is the fourth in a series of reports resulting from our audit of controls over munitions list items. The audit was requested by the Director, Defense Logistics Agency (DLA). The first two reports are summarized below.

Inspector General, DoD, Report No. 96-143, "Transfer and Exchange of a Navy P-3A Aircraft," June 5, 1996. The objective of this portion of the overall audit was to determine whether the Navy effectively managed the transfer of reclaimable aircraft to museums.

The Navy planned to transfer a P-3A aircraft, with usable parts valued at $1.7 million to $4.1 million, to the Smithsonian’s National Air and Space Museum. The museum, in turn, planned to exchange the P-3A for a historically significant business aircraft valued at $245,000. As a result of our audit, the Navy conducted further research and canceled the transfer. The Navy confirmed that it had current requirements for parts on the P-3A. In addition, the planned exchange was not in the best interest of the Government. Management actions resulted in monetary benefits of $1.7 million to $4.1 million. The report made no recommendations.

Inspector General, DoD, Report No. 96-229, "Disposition of Excess Army Helicopters and Flight-Safety-Critical Helicopter Parts," September 24, 1996. The objective of this portion of the audit was to determine whether the Army had effective controls over the redistribution and disposition of excess helicopters and helicopter parts.

The Aviation and Troop Command did not give the Defense Reutilization and Marketing Service (DRMS) correct instructions for disposing of flight-safety-critical parts that were released to the public without safety inspections. Consequently, $37.5 million of flight-safety-critical parts were released to the public without safety inspections, and $153.1 million of salable parts were incorrectly coded for demilitarization. We recommended that the Commander, Aviation and Troop Command, modify the Component Tracking System to provide complete disposition instructions on flight-safety-critical parts by work-unit code. We also recommended that the Commander, Aviation and Troop Command, coordinate with the Defense Reutilization and Marketing Service and the Regional Logistics Support Offices to modify the Component Tracking System to provide complete disposition instructions on flight-safety-critical parts by work-unit code; provide retroactive instructions for disposing of previously reutilized, transferred, donated, or exchanged flight-safety-critical parts; and research the history of the flight-safety-critical parts already on hand at Defense Reutilization and Marketing Offices and national inventory control points before the parts are released.

The Aviation and Troop Command transferred 170 helicopters to the U.S. Army Center of Military History for exchange purposes, although the helicopters were not historic property. The Center of Military History incorrectly exchanged 86 of the helicopters for other historic property or contractor services. The helicopters that were exchanged were not properly
Appendix B. Prior Audits and Other Reviews

valued, and the exchanges were not reported to the Internal Revenue Service as required. The Center of Military History's actions did not comply with DoD policies on exchanges and valuation requirements of 10 U.S.C. 2572. The exchanges increased the risk that flight-safety-critical helicopter parts on the helicopters were released outside DoD without the necessary safety inspections. We recommended that the Army Chief of Staff dispose of the 84 helicopters that were transferred to the Center of Military History in accordance with DoD and Army disposal policies; identify the 86 helicopters exchanged between the public and the Center of Military History to determine whether flight-safety-critical parts that were released should be recalled for inspection; and improve policies, procedures, and controls for implementing exchange provisions of DoD policies and 10 U.S.C. 2572.

DRMS did not reimburse the Aviation and Troop Command for the sale of excess helicopters and related parts. As a result, the Army's Defense Business Operations Fund will not receive approximately $60 million from the sale of helicopters and $10 million from the sale of helicopter engines. Redirecting these funds will give the Army the incentive to maximize proceeds on the sale of excess helicopters and related parts. We recommended that the Under Secretary of Defense (Comptroller) approve reimbursement to the Army of 80 percent of the proceeds from the sale of excess helicopters and related parts.

We also recommended the Deputy Under Secretary of Defense (Logistics) ask the DLA and the Services to identify and provide the status of any efforts they have made to comply with a DoD policy memorandum issued by the Assistant Deputy Under Secretary (Materiel and Resource Management) "Surplus Helicopters," July 25, 1995. Management nonconcurred with several of the recommendations. The report has been referred for mediation.
Appendix C. Demilitarization Codes

On February 14, 1995, DoD reduced the number of authorized demilitarization codes from 15 to 9. Those nine codes and their definitions are defined below.

A  Non-MLI/nonstrategic list item. Demilitarization not required.

B  MLI (nonsignificant military equipment). Demilitarization not required, trade security controls should be applied.

C  MLI (significant military equipment). Remove and/or demilitarization installed key points.

D  MLI (significant military equipment). Total destruction of items and components to prevent restoration or repair to a usable condition.

E  MLI (nonsignificant military equipment). Additional critical items/materiel determined to require demilitarization, either key point or total destruction. Demilitarization instructions to be furnished by the DoD Demilitarization Program Office.

F  MLI (significant military equipment). Demilitarization instructions to be furnished by the item/technical manager.

G  MLI (significant military equipment). Demilitarization required—ammunition, explosives, and dangerous articles. Demilitarization and, if required, declassification will be accomplished prior to physical transfer to a Defense Reutilization and Marketing Office.

P  MLI (significant military equipment). Security classified item. Declassification and any additional demilitarization and removal of sensitive markings will be accomplished prior to accountability or physical transfer to a Defense Reutilization and Marketing Office.

Q  Strategic list item. Demilitarization not required.
Appendix D. United States Munitions List

1. Firearms
2. Artillery and projectors
3. Ammunition
4. Launch vehicles, guided missiles, ballistic missiles, rockets, torpedoes, bombs, and mines
5. Explosives, propellants, incendiary agents, and their constituents
6. Vessels of war and special naval equipment
7. Tanks and military vehicles
8. Aircraft, spacecraft, and associated equipment
9. Military training equipment
10. Protective personnel equipment
11. Military and space electronics
12. Fire control, range finder, optical and guidance and control equipment
13. Auxiliary military equipment
14. Toxicological agents and equipment and radiological equipment
15. Spacecraft systems and associated equipment
16. Nuclear weapons design and test equipment
17. Classified articles, technical data, and Defense services not otherwise enumerated

[18. and 19. Reserved for future use]
20. Submersible vessels, oceanographic and associated equipment
21. Miscellaneous articles
Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Acquisition and Technology)
  Deputy Under Secretary of Defense (Industrial Affairs and Installations)
  Deputy Under Secretary of Defense (Logistics)
  Director, Defense Procurement
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Under Secretary of Defense for Policy
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
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Department of the Air Force

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

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Investigative Service
Director, Defense Logistics Agency
  Director, Defense Contract Management Command
  Commander, Defense Reutilization and Marketing Service
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency
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Part III - Management Comments
MEMORANDUM FOR ACTING DIRECTOR, FINANCE AND ACCOUNTING DIRECTORATE, OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Audit Report on Coding Munitions List Items (Project No. SFJ-8024.03)

Our comments on the subject draft report are provided below in response to your memorandum of December 12, 1996.

RECOMMENDATION: We recommend that the Deputy Under Secretary of Defense (Logistics) consolidate the responsibility to assign, challenge, and maintain demilitarization codes into a single office; staff the office with individuals responsible for all aspects of demilitarization, and include all items managed by the Defense Logistics Agency and the Military Department inventory control points.

ODUSD(L) COMMENT: Partially concur. We suggest that the recommendation would be more effective if it were modified to indicate that the Deputy Under Secretary of Defense (Logistics) should give strong consideration to centralized coding in the overall improvement of the DoD demilitarization program. This suggestion is based on the following:

- While we may agree that coding consolidation may be the best approach, there are alternatives and other factors that must be considered. This office is in the process of implementing both long and short term initiatives designed to improve the overall demilitarization program as opposed to one area (coding). We have already tasked the Military Services and the Defense Logistics Agency (DLA) to conduct critical reviews of the demilitarization coding process. We are in the process of developing an action plan addressing the overall demilitarization program which may include establishment of a working group of pertinent federal agencies to address changes to their role in the demilitarization process and legislative changes. The plan may also involve a Department of Defense (DoD) work group to address improvements to the present process within DoD. We plan to monitor progress of these groups through the DoD Materiel Management Steering Group which includes top level logistics leaders in DoD.
One of the improvements we are considering is the consolidation of the coding function. However, this has not been proven to be the best approach and the financial, availability and maintainability of technical knowledge, and operational aspects of such a consolidation are major considerations to be addressed in the final decision process. Establishing a central office would require considerable financial and personnel commitment with no guarantee that it would work any better than the present system.

Although DLA has indicated that they are in favor of centralized coding (primarily based on the fact that nothing else has worked), the Military Services have voiced strong opposition (primarily based on concern that technical expertise is, and must remain, within the Service). We would need a strong selling point to override the opposition. This is not apparent now, but may be during our re-engineering project.

There are several areas in the draft report that do not fully support the recommendation.

- The new coding policy, dated February 14, 1995, was not distributed when the statistical sample was taken addressing the degree of coding inaccuracy, the draft is not specific as to who/how the sample determined that the items sampled were inaccurate.

- The draft report does not provide proof to demonstrate that inaccurate coding is DoD-wide or limited to a single component or ICP.

- The predominant part of the sample involved DLA vs. Military Service managed items, perhaps indicating that DLA should centralize coding.

- Page 1, Executive Summary, Audit Results: The statement that DoD components assigned inaccurate codes to 52 percent of items requiring controls, resulting in sensitive military hardware being offered/sold without demilitarization, is misleading. The chart on page 6 of the draft report shows that most of the miscoded items were overcoded: i.e., coded demilitarization required, when, in fact, the items did not require demilitarization. That condition would not result in sensitive military hardware being offered/sold without demilitarization. Instead, it would result in an unnecessary expenditure of resources to demilitarize items that do not actually require demilitarization.
Final Report
Reference

- Page 5, Assignment of Demilitarization Codes, first paragraph, last sentence, is incorrect. The implication is that the recoding effort was an attempt to correct the demilitarization coding process. However, the recoding effort was an attempt to correct demilitarization coding for selected items in the existing inventory. It was not designed to correct the coding process.

- The draft report does not indicate whether the assigning and reviewing Inventory Control Point (ICP) were the same, nor whether the person making the final coding determination had the appropriate knowledge to make such a determination. The draft indicates that ICP personnel with coding responsibility are doing so without weapon system knowledge. It would appear that there would be less specific knowledge in a centralized function.

- Consolidated coding may reduce the demilitarization training problem. However, it would create another problem in technical weapon system training in a central office.

John F. Phillips
Deputy Under Secretary of Defense (Logistics)
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