TOM DAVIS, VIRGINIA,
CHAIRMAN

CHRISTOPHER SHAYS, CONNECTICUT
DAN BURTON, INDIANA
ILEANA ROS-LEHTINEN, FLORIDA
JOHN M. McHUGH, NEW YORK
JOHN L. MICA, FLORIDA
GIL GUTKNECHT, MINNESOTA
MARK E. SOUDER, INDIANA
STEVEN C. LATOURETTE, OHIO
TODD RUSSELL PLATTS, PENNSYLVANIA
CHRIS CANNON, UTAH
JOHN J. DUNCAN, JR., TENNESSEE
CANDICE MILLER, MICHIGAN
MICHAEL R. TURNER, OHIO
DARRELL ISSA, CALIFORNIA
JON C. PORTER, NEVADA
KENNY MARCHANT, TEXAS
LYNN A. WESTMORELAND, GEORGIA
PATRICK T. McHENRY, NORTH CAROLINA
CHARLES W. DENT, PENNSYLVANIA
VIRGINIA FOXX, NORTH CAROLINA
JEAN SCHMIDT, OHIO
BRIAN P. BILBRAY, CALIFORNIA

ONE HUNDRED NINTH CONGRESS

Congress of the United States
House of Representatives

COMMITTEE ON GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6143

MAJORITY (202) 225–5074
FACSIMILE (202) 225–3974
MINORITY (202) 225–5051
TTY (202) 225–6852

http://reform.house.gov

HENRY A. WAXMAN, CALIFORNIA,
RANKING MINORITY MEMBER

TOM LANTOS, CALIFORNIA
MAJOR R. OWENS, NEW YORK
EDOLPHUS TOWNS, NEW YORK
PAUL E. KANJORSKI, PENNSYLVANIA
CAROLYN B. MALONEY, NEW YORK
ELIJAH E. CUMMINGS, MARYLAND
DENNIS J. KUCINICH, OHIO
DANNY K. DAVIS, ILLINOIS
WM. LACY CLAY, MISSOURI
DIANE E. WATSON, CALIFORNIA
STEPHEN F. LYNCH, MASSACHUSETTS
CHRIS VAN HOLLEN, MARYLAND
LINDA T. SANCHEZ, CALIFORNIA
C.A. DUTCH RUPPERSBERGER,
MARYLAND
BRIAN HIGGINS, NEW YORK
ELEANOR HOLMES NORTON,
DISTRICT OF COLUMBIA

BERNARD SANDERS, VERMONT,
INDEPENDENT

SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS,
AND INTERNATIONAL RELATIONS
Christopher Shays, Connecticut
Chairman
Room B-372 Rayburn Building
Washington, D.C. 20515
Tel: 202 225-2548
Fax: 202 225-2382

MEMORANDUM

To: Members of the Subcommittee on National Security, Emerging Threats, and International Relations

From: Christopher Shays
Chairman

Date: July 20, 2006

Subject: Briefing memo for the July 25th Subcommittee hearing

---

Attached find the briefing memo required by Committee rules for the hearing on Tuesday, July 25th entitled, *DOD EXCESS PROPERTY: Inventory Control Breakdowns Present a Security Risk*. The hearing will convene at 2:00 p.m., room 2154 Rayburn House Office Building, Washington, D.C.

TOM DAVIS, VIRGINIA,
CHAIRMAN

CHRISTOPHER SHAYS, CONNECTICUT
DAN BURTON, INDIANA
ILEANA ROS-LEHTINEN, FLORIDA
JOHN M. McHUGH, NEW YORK
JOHN L. MICA, FLORIDA
GIL GUTKNECHT, MINNESOTA
MARK E. SOUDER, INDIANA
STEVEN C. LaTOURETTE, OHIO
TODD RUSSELL PLATTS, PENNSYLVANIA
CHRIS CANNON, UTAH
JOHN J. DUNCAN, JR., TENNESSEE
CANDICE MILLER, MICHIGAN
MICHAEL R. TURNER, OHIO
DARRELL ISSA, CALIFORNIA
JON C. PORTER, NEVADA
KENNY MARCHANT, TEXAS
LYNN A. WESTMORELAND, GEORGIA
PATRICK T. McHENRY, NORTH CAROLINA
CHARLES W. DENT, PENNSYLVANIA
VIRGINIA FOXX, NORTH CAROLINA
JEAN SCHMIDT, OHIO
BRIAN P. BILBRAY, CALIFORNIA

ONE HUNDRED NINTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

2157 RAYBURN HOUSE OFFICE BUILDING

WASHINGTON, DC 20515–6143

MAJORITY (202) 225–5074
FACSIMILE (202) 225–3974
MINORITY (202) 225–5051
TTY (202) 225–6852

http://reform.house.gov

HENRY A. WAXMAN, CALIFORNIA,
RANKING MINORITY MEMBER

TOM LANTOS, CALIFORNIA
MAJOR R. OWENS, NEW YORK
EDOLPHUS TOWNS, NEW YORK
PAUL E. KANJORSKI, PENNSYLVANIA
CAROLYN B. MALONEY, NEW YORK
ELIJAH E. CUMMINGS, MARYLAND
DENNIS J. KUCINICH, OHIO
DANNY K. DAVIS, ILLINOIS
WM. LACY CLAY, MISSOURI
DIANE E. WATSON, CALIFORNIA
STEPHEN F. LYNCH, MASSACHUSETTS
CHRIS VAN HOLLEN, MARYLAND
LINDA T. SANCHEZ, CALIFORNIA
C.A. DUTCH RUPPERSBERGER, MARYLAND
BRIAN HIGGINS, NEW YORK
ELEANOR HOLMES NORTON, DISTRICT OF COLUMBIA

BERNARD SANDERS, VERMONT,
INDEPENDENT

SUBCOMMITTEE ON NATIONAL SECURITY, EMERGING THREATS,
AND INTERNATIONAL RELATIONS
Christopher Shays, Connecticut
Chairman
Room B-372 Rayburn Building
Washington, D.C. 20515
Tel: 202 225-2548
Fax: 202 225-2382

July 20, 2006

MEMORANDUM

To: Members of the Subcommittee on National Security, Emerging Threats, and International Relations

From: J. Vincent Chase, Chief Investigator

Re: Briefing memo for the hearing *DOD EXCESS PROPERTY: Inventory Control Breakdowns Present a Security Risk* scheduled for July 25, 2006 at 2:00 p.m. in room 2154 Rayburn.

PURPOSE OF THE HEARING

The purpose of the hearing is to determine the extent of waste and inefficiency in the Department of Defense (DOD) program for the reutilization of excess military property.

HEARING ISSUES

1. **What effective controls are in place to prevent sensitive military equipment that requires demilitarization (destruction) from falling into the wrong hands?**

2. **How effective are DOD system and process improvements to prevent the sales of new or unused items that DOD continues to buy or that are in demand by the military services?**

BACKGROUND

The Defense Logistics Agency (DLA) **(Attachment 1)** is the Department of Defense combat support agency under the supervision, direction, authority, and control of the Under Secretary of Defense for Acquisition, Technology, and Logistics. The DLA mission is to provide logistics support to America's armed forces, in peace and in war. To carry out this mission, DLA manages an inventory valued at about $89.2 billion, consisting of consumable items, including fuel, food, clothing, medical supplies, industrial use items, and spare and repair parts supporting weapon systems. DLA also buys and distributes hardware and electronic items that are used in maintenance and repair of equipment and weapons systems. **(Web Resource 1)**

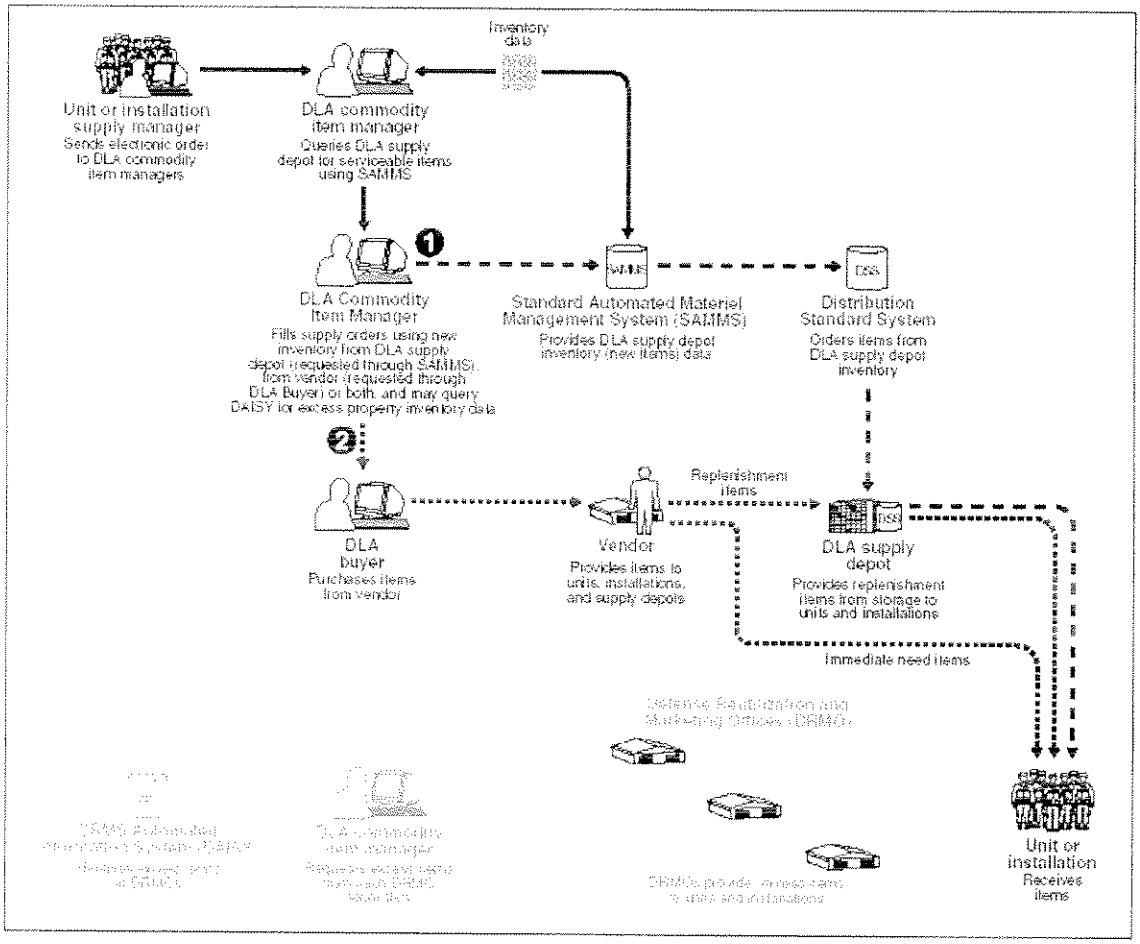
In fiscal year 2005, DLA expenditures related to the purchase of goods and services amounted to over $31.8 billion for commodity purchases and for the Defense Reutilization and Marketing Service (DRMS) excess property disposal services. DLA and DRMS operate under the Defense-wide Working Capital Fund.[1] DLA is financed through user charges to cover costs, and DRMS is financed through user charges and excess property and scrap sale proceeds.

DLA commodity acquisition is carried out by three Defense Supply Centers, located in Columbus, Ohio; Richmond, Virginia; and Philadelphia, Pennsylvania. The DLA acquisition process focuses on the acquisition of inventory requisitioned by the military services for immediate use and routine inventory replenishment. Defense Supply Center item managers initiate commodity procurements based on military unit requirements for materiel and supplies and military unit requisitions (supply orders). Supply Center item managers consolidate the requirements and work with buyers to procure requested items. Items for which there are immediate needs are delivered directly to a military unit by the commercial vendor, and items needed to support anticipated operations are stored at DLA supply depots for later issue.

[1] The Defense-wide Working Capital Fund is a revolving fund that the Secretary of Defense has established under authority of 10 U.S.C. § 2208.

The DLA Defense Distribution Center uses a total of 26 DLA supply depots located throughout the United States and Europe, as well as in Guam and Kuwait, to store consumables and other items that are classified and sorted by over 5 million different national stock numbers[2] (NSNs). **(Web Resource 2, pg. 6)**

Figure 1: DLA Commodity Acquisition and Distribution Process



Source: GAO

(Web Resource 2 pg.10)

[2] An NSN is a 13-digit number that identifies standard use inventory items. The first 4 digits of the NSN represent the Federal Supply Classification, such as 8430 for men's footwear, followed by a 2-digit NATO code and a 7-digit designation for a specific item, such as a cold weather boot.

Disposal of Excess Property

The Federal Property and Administrative Services Act[3], as amended, places responsibility for the disposal of government real and personal property with the General Services Administration (GSA). The Act requires GSA to delegate disposal of Department of Defense (DOD) property to the Secretary of Defense, who in turn delegated this responsibility to the Defense Logistics Agency.

The Defense Reutilization and Marketing Service is responsible for the day-to-day management of the Department of Defense excess property disposal program. The DRMS mission is "to provide the best value services to customers for the reuse, transfer, donation, sale or disposal of excess property." **(Attachment 2)**

In accordance with federal regulations governing property management[4] and DOD policy outlined in the *Defense Materiel Disposition Manual*, DOD agencies and military services are responsible for determining whether property they hold is considered excess. **(Web Resource 3)** When a DOD component has property no longer needed, the property is turned over to a Defense Reutilization and Marketing Service field office, referred to as a DRMO. **(Attachment 3)**

DRMS disposes of excess property received from all DOD components. The inventory changes daily and includes thousands of items from clothing, vehicles, computers, hospital and laboratory equipment to scrap from Naval ships and much more. Excess items that are available for reuse are first offered to DOD components and 11 special excess material disposal programs authorized by Congress. **(Attachment 4)**

Property that is not reutilized or transferred to other federal agencies can be donated to states and local governments and other qualified organizations. The redistribution of excess property is intended to allow the government to make full use of excess items, avoid unnecessary procurement of property and improve economy and efficiency of operations.

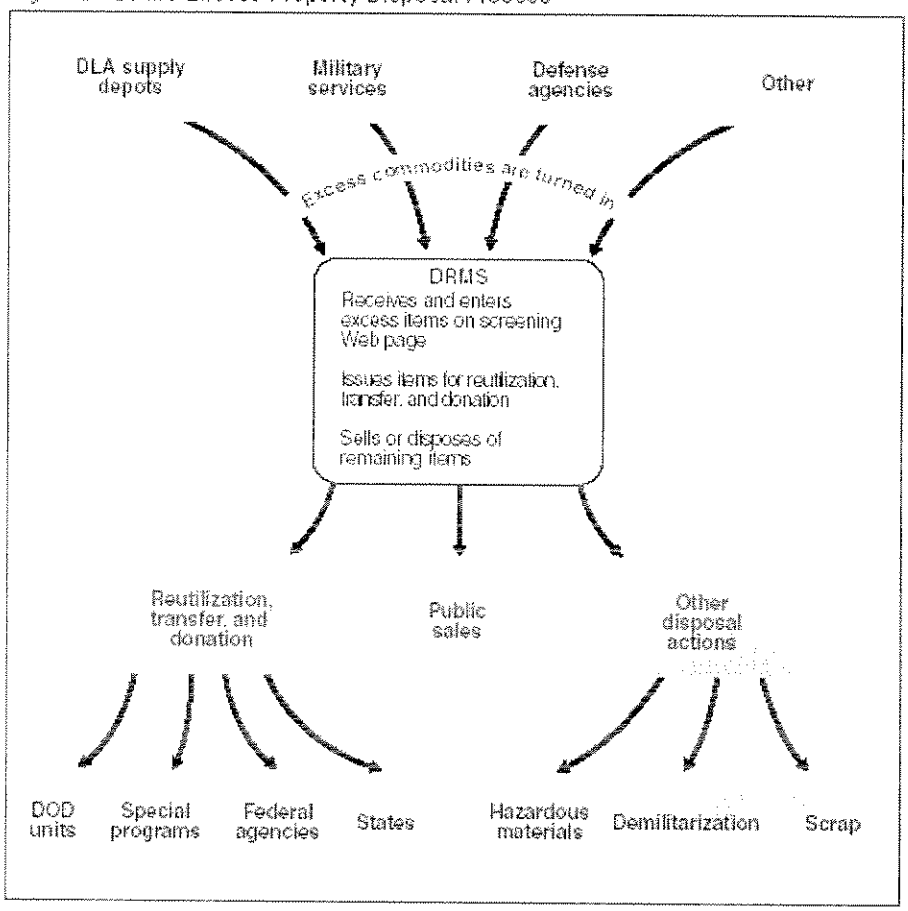
---

[3] 40 U.S.C. 10

[4] *Federal Property Management Regulations*, 41 C.F.R. Chapter 101 and the *Federal Management Regulation*, 41 C.F.R. Chapter 102 (2003), issued by the General Services Administration.

Any residual property that is not reutilized, transferred, or donated can be sold to the public. **(Web Resource 2, pg. 14)**

Figure 2: DRMS Excess Property Disposal Process



Source: GAO

For sales to the general public DRMS has a commercial partnership with Government Liquidation, LLC to purchase and re-sell non-demilitarization[5] usable property in the United States, Guam, Hawaii and Puerto Rico. **(Attachment 5)** Government Liquidation, LLC **(Web Resource 3)** markets these items over the Internet, allowing anyone to view, select, and bid on items they wish to purchase. Sales include high-value property, such as aircraft parts, machine tools, hardware, laboratory equipment, electronics, material handling equipment, vehicles, personnel

[5] The demilitarization program is a major part of the DRMS mission. It prevents offensive and defensive equipment from being released to the public.

clothing and equipment. If Government Liquidation, LLC is not successful in selling excess items, it returns these items to DRMS for scrap and recycling. **(Web Resource 3)**

Outdated Inventory Management Systems Impair Program Efficiency

Inefficient, nonintegrated excess inventory management systems lack controls necessary to prevent waste in the excess property reutilization program. GAO has reported over many years the DRMS Automated Inventory System (DAISY) and Defense Logistic Agency Standard Automated Materiel Management System (SAMMS) are outdated and nonintegrated. The systems do not share information necessary to identify and alert DLA managers of excess property that is available to fill supply orders and prevent purchases of new items when "A" condition excess items are available for reutilization. In addition, military units do not know how many items they have and where these items are located.

According to GAO, DLA has acknowledged serious deficiencies in its automated inventory management systems. Although DLA has an effort under way to replace SAMMS with the Business Systems Modernization (BSM) and DRMS has a Reutilization Modernization Program (RMP) under way to upgrade DAISY, so far these have been separate, uncoordinated efforts and they do not adequately address identified process deficiencies. Also, while the systems improvement efforts are intended to integrate supply and excess inventory systems to support the reutilization program, they are not focused on resolving long-standing problems related to unreliable condition code data and incomplete data on national stock numbers. The accuracy of these two data elements is critical to the ability to identify like items that are available for reutilization at the time purchases are made.

The Demilitarization Program

The Demilitarization Program was designed to prevent offensive, defensive and highly sensitive equipment from being released to the public. **(Attachment 6)** The DOD demilitarization policy establishes specific codes **(Attachment 7)** (that are designed to indicate whether DOD property is available for reuse without restriction, or whether specific restrictions apply,

such as removal of classified components, destruction of sensitive military technology, or trade security control.[6]

Examples of items with a demilitarization requirement include tanks, some electronics equipment, military aircraft, night-vision devices, infra-red (IR) reflective textiles (used for clothing, tarps and tents), radio sets, and optical sights. DOD requires that buyers who purchase items subject to trade security controls be subjected to pre-sales clearance procedures, including a background check and submission and approval of an End Use Certificate.[7] The Defense Logistics Agency Criminal Investigations Activity (DCIA) is responsible for pre-sale clearances and monitoring of post-sale compliance with DOD End Use Certificate requirements.

In October 2003, the Subcommittee held the first in a series of oversight hearings of DLA inventory processes and controls, entitled, *Emerging Threats: Assessing DOD Control of Surplus Chemical and Biological Equipment and Material.*[8] The purpose of the hearing was to learn why the latest CB suit technology was discarded as excess property and being sold on the Internet when the military services were reporting a shortage of these CB suits. As a result of this hearing, the Subcommittee decided to look more broadly at DLA inventory processes and procedures for the disposal of excess property to determine the extent of waste and inefficiency in the excess property program.

In response to the Subcommittee investigation of DLA inventory processes and controls, the Government Accountability Office (GAO) prepared a report entitled, *DOD EXCESS PROPERTY: Management Control Breakdowns Result in Substantial Waste and Inefficiency*, (GAO-05-277) which was the subject of the June 7, 2005 hearing. **(Web Resource 2))** GAO testified and provided examples of DOD transferring, donating, or

[6] Trade Security Controls are policies and procedures designed to prevent the sale or shipment of U.S. Government materiel to any person, organization, or country whose interests are unfriendly or hostile to those of the United States.

[7] The End Use Certificate indicates the destination and disposition of sensitive, controlled items, such as military equipment, technical data, or dual use items.

[8] Hearing before the House Subcommittee on National Security, Emerging Threats and International Relations, *Emerging Threats: Assessing DOD Control of Surplus Chemical and Biological Equipment and Material, October 7, 2003, US Government Printing Office, Serial No. 108-121.*

selling excess property in new or good condition at the same time the Department is purchasing the same or similar new items.

In response to the June 7, 2005 hearing, the Subcommittee asked the GAO to investigate DLA's assertion that controls were adequate to prevent items requiring demilitarization from being released to unauthorized parties. **(Attachment 8)**

In addition, DOD officials promised to have systems enhancements in place by January 2006 to assure that excess items in new and unused condition that the military services are continuing to use are returned to inventory and reutilized within DOD to avoid unnecessary purchases.

As a result of the investigation, GAO was able to buy demiliteraized equipement which is the subject of today's hearing. During the hearing GAO will release the report entitled, *DOD Excess Property: Control Breakdowns Present Significant Security Risk and Continuing Waste and In efficiency*, GAO- 06-943. **(Attachment 9)**

DISCUSSION OF HEARING ISSUES

What effective controls are in place to prevent sensitive military equipment that requires demilitarization (destruction) from falling into the wrong hands?

GAO security tests found that sensitive military equipment items are still being improperly released by DOD and sold to the public, thus posing a national security risk. The sensitive nature of these items requires particularly stringent internal security controls. Some of the items obtained by GAO during their undercover investigation include:

- *Time Selector Unit* used to assure the accuracy of global positioning systems with an original acquisition cost of $343,695 for $65. **(Attachment 9, pg. 8-9)**

- *Guided Missile Launcher Mounts* used to provide the electrical connection between the round and the tracker and contain a remote firing mechanism for the wire guided Dragon missiles with an original

acquisition cost of $6,246 were obtained by GAO investigators posing as DOD contractor employees. **(Attachment 9, pg. 17-18)**

- *All-Brand Antenna* used by the Air Force to track aircraft with a reported acquisition cost of $120,000. **(Attachment 9, pg. 20-21)**

- Other items obtained by GAO include *body armor*, *guided weapons radar test sets* used to check the operation of the data link antenna on the Navy's *Walleye* air-to-ground guided missile delivered by the *F/A 18-Hornet* fighter aircraft, and *circuit card assemblies* are used in a variety of computerized Navy systems.

Security tests, which were performed over a short duration, were limited to GAO observations, meaning that the problem may likely be more significant than what GAO identified. Although GAO have referred the sales of items identified during the investigation to federal law enforcement agencies for follow-up, the solution to this problem is to enforce controls for preventing improper release of these items outside DOD. **(Attachment 9, pg. 30)**

The causes of control breakdowns identified by GAO in clued the following:.

- Some military units and DLA supply depots recorded incorrect demilitarization codes to excess military property items and in some cases improperly included these items in batch lots before sending these items to Defense Reutilization and Marketing Offices (DRMOs).

- DRMO personnel failed to verify the recorded demilitarization codes when they processed receipts of excess military property.

- The limited scope of DLA and DRMS compliance reviews is not sufficient to detect problems with incorrect demilitarization codes.

- DOD's excess property liquidation sales contractor failed to verify demilitarization codes of items received and return items requiring mutilation or destruction to the DRMO for proper disposal.

How effective are DOD system and process improvements to prevent the sales of new or unused items that DOD continues to buy or that are in demand by the military services?

Although DLA and DRMS implemented several initiatives to improve the overall reutilization rate for excess A-condition items[9], the GAO analysis of DRMS data found that the reported reutilization rate as of June 2006 remained the same at 12 percent as previously reported. This is primarily because DLA reutilization initiatives are limited to using available excess A-condition items to fill customer orders and to maintain established supply inventory retention levels. As a result, excess A-condition items that are not needed to fill orders or replenish supply inventory are disposed of outside of DOD through transfers, donations, and public sales. The disposal of items that exceed customer orders and inventory retention levels is an indication that DOD bought more items than it needed. In addition, several of the items purchased at liquidation sales events were being ordered from supply inventory by military units at or near the time of GAO's purchase indicating that excess items in new and unused condition that the military services are continuing to use are not returned to inventory and reutilized within DOD. **(Attachment 9, pg. 28-29)**

Although the excess property reutilization has remained static, according to DLA data as of June 30, 2006, interim supply system initiatives using the Automated Asset Recoupment Program, which is part of an old legacy system, achieved reutilization savings of nearly $2.3 million since July 2005, while Business System Modernization supply system initiatives, implemented in January 2006 as promised at the Subcommittee's June 2005 hearing, have resulted in reutilization savings of nearly $1.1 million. In addition, DRMS reported that excess property marketing initiatives implemented in late March 2006 have resulted in reutilization savings of a little over $34.8 million through June 2006. These initiatives include marketing techniques using Web photographs of high-dollar items **(Web Resource 5)** and e-mail notices to repeat customers about the availability of A-condition items that they had previously selected for reutilization. **(Attachment 9, pg. 29)**

[9] Items that are reported to be in new, unused, or in excellent condition are referred to as "A" condition.

WITNESS TESTIMONY

PANEL ONE

Mr. Gregory Kutz, Managing Director, Forensic Audits and Special Investigations, U.S. General Accounting Office will testify about GAO's review of DOD control over the excess property program. GAO found approximately $3.5 billion in waste related to the DOD excess property reutilization program.

PANEL TWO

Mr. Alan F. Estevez, Assistant Deputy Under Secretary of Defense (Supply Chain Integration), Department of Defense will testify about DOD guidelines, policies, procedures, and the oversight of these guidelines for controlling the disposal of excess property.

MG Bennie E. Williams, Director for Logistics Operations, Defense Logistics Agency will testify about DLA disposal of excess property procedures and oversight of DRMS.

Mr. Paul Peters, Director, Defense Reutilization and Marketing Service, Department of Defense will testify about management oversight and disposal of excess property under the Demilitarization Program.

ATTACHMENTS

1. *Defense Logistics Agency Quick Facts*, News Release, Public Affairs Division, March 2006.

2. Defense Logistics Agency, Defense Reutilization and Marketing Service, *DRMS: "At a Glance,"* March 17, 2004.

3. Defense Reutilization and Marketing Service field office, National Commend 2003, Site Map.

4. Department of Defense, Defense Logistics Agency, *Special Excess Material Disposal Programs.*

5. Government Liquidation, LLC, a subsidiary of Liquidity Services, Inc.

6. Defense Logistics Agency, Defense Reutilization and Marketing Service, *The Demilitarization Program*, updated April 2001.

7. Defense Logistics Agency, Excess Property Condition Codes.

8. *DOD EXCESS PROPERTY: Management Control Breakdowns Result in Substantial Waste and Inefficiency*, GAO-05-277, pg. 106, May 2005.

WEB RESOURCES

1. The Defense Logistics Agency (DLA)
< http://www.dla.mil/about.asp> (accessed July 10, 2006)

2. *DOD EXCESS PROPERTY: Management Control Breakdowns Result in Substantial Waste and Inefficiency*, GAO-05-277, May 2005
< http://www.gao.gov/new.items/d05277.pdf> (accessed July 11, 2006)

3. The Defense Logistics Agency (DLA),
DLA Publishing Systems e-Guide
Defense Materiel Disposition Manual, DOD 4160.21-M
< http://www.dla.mil/dlaps/dod/416021m/guide.asp> (accessed July 11, 2006)

4. Government Liquidation, LLC, a subsidiary of Liquidity Services, Inc.
<http://www.govliquidation.com/about/index.html > (accessed July 12, 2006)

5. Defense Reutilization and Marketing Office (DRMO)
< https://www.drms.dla.mil/rtd03/index.html> (accessed July 12, 2006)

WITNESS LIST

PANEL ONE

Mr. Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations
U.S. Government Accountability Office

accompanied by

Ms. Gayle L. Fischer, Assistant Director
Forensic Audits and Special Investigations

Mr. John J. Ryan, Assistant Director/Special Agent
Forensic Audits and Special Investigations

Mr. Richard C. Newbold, Special Agent
Forensic Audits and Special Investigations

PANEL TWO

Mr. Alan F. Estevez
Assistant Deputy Under Secretary of Defense (Supply Chain Integration)
Department of Defense

MG Bennie E. Williams
Director for Logistics Operations
Defense Logistics Agency

Mr. Paul Peters, Director
Defense Reutilization and Marketing Service
Department of Defense