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BY THE U.S. GENERAL ACCOUNTING OFFICE  
**Report To The Secretary Of Defense**

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## Incentive Programs To Improve Productivity Through Capital Investments Can Work

In 1979, the Congress established the Productivity Enhancing Incentive Fund to enable the Department of Defense to quickly buy and install equipment that will pay back its cost in 2 years. The program concept has proven successful in the Air Force and Army. However, greater management attention is needed for the program to fully meet congressional requirements and to ensure that the program becomes successful in the Navy.



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AFMD-81-43  
APRIL 20, 1981

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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

ACCOUNTING AND FINANCIAL  
MANAGEMENT DIVISION

B-202363

The Honorable Caspar W. Weinberger  
The Secretary of Defense

Dear Mr. Secretary:

This report discusses our review of the Defense Department's Productivity Enhancing Incentive Fund. It contains recommendations to improve the management of the Fund's program, particularly in the area of insuring that equipment investments are adequately justified prior to procurement and adequately evaluated after installation.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations. You must send the statement to the House Committee on Government Operations and the Senate Committee on Governmental Affairs within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of the report.

Copies of this report will be sent to the Senate and House Committees on Appropriations; the Senate Committee on Governmental Affairs; the House Committee on Government Operations; Subcommittee on Defense, House Committee on Appropriations; and the Secretaries of the Air Force, Army, and Navy.

Sincerely yours,

A handwritten signature in cursive script, reading "D. L. Scantlebury".

D. L. Scantlebury  
Division Director and  
Chief Accountant of GAO



GENERAL ACCOUNTING OFFICE  
REPORT TO THE SECRETARY  
OF DEFENSE

INCENTIVE PROGRAMS  
TO IMPROVE PRODUCTIVITY  
THROUGH CAPITAL INVESTMENTS  
CAN WORK

D I G E S T

The primary source of improved national productivity has traditionally been new and technologically advanced capital equipment. Recognizing this, the Department of Defense established a number of programs in the 1970s to simplify the procurement of productivity enhancing capital equipment. One such program entailed the establishment by the Congress of special funds for buying equipment that could pay for itself in 2 years through cost savings. Now called the Productivity Enhancing Incentive Fund, the program was reviewed and reported on by GAO in June 1978. About the same time, the Congress temporarily stopped funding the program because of its concern over circumvention of the normal budget process. In the 1978 report, GAO supported the Fund concept and recommended its reestablishment, while simultaneously pointing out program deficiencies and recommending changes. As a result, the Congress reinstated the program in 1979.

Except for the Navy, the services' program management has improved since GAO's 1978 review. The Air Force and Army efforts have demonstrated that under the program, good ideas can be quickly evaluated and funded and savings made promptly. For example, 10 Air Force projects GAO examined should produce \$153,300 in annual savings in return for their \$129,000 cost. The average time between project identification and approval for financing was 2.5 months. Traditional funding channels require more than 2 years. (See p. 11.)

However, the full potential of this fast pay-back program has not been realized because of inadequate management attention. For example, the Office of the Secretary of Defense has not closely monitored the services' management of their Fund programs to ensure attainment of program credibility and compliance with congressional guidance. Although the Defense Productivity Program Office devised plans in 1978 for

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improving Fund operations, it has been slow to implement many planned actions because of its limited staff. Defense resources have been applied to all productivity improvement programs in proportion to program size and expected benefits. Since the Productivity Enhancing Incentive Fund program is a relatively small one, a determination must be made whether resources can be diverted back to it. (See pp. 5-7.)

The Air Force and the Army also need to improve their postinvestment analysis and reporting to clearly demonstrate Fund program benefits and meet congressional requirements.

The Navy particularly has not devoted the management resources and emphasis needed to ensure a successful and credible Productivity Enhancing Incentive Fund program. GAO found that the Navy's program was not being adequately promoted; Navy guidance did not fully comply with Office of the Secretary of Defense and congressional guidance; extensive delays occurred between investment identification and installation; the justification for many approved projects was invalid or insupportable; and post-installation analyses were inadequate.

To illustrate the problems in the Navy's program, the justifications for 12 of 13 Navy projects GAO reviewed were either inaccurate, invalid, or could not be supported with existing documentation. During the review, the Navy canceled three of these projects that were on the verge of procurement because the equipment was no longer needed by the requesting activities. (See pp. 19-21.)

## CONCLUSIONS

GAO believes the concept of a specially funded program for capital investments with fast paybacks is valid and should be adequately supported, but without proper Defense oversight and guidance the program can be ineffective and funds can be wasted. Further, GAO believes that to fully meet congressional and Defense requirements for the program, the Air Force and the Army must improve their postaudit efforts while the Navy must give major management attention to all program aspects. (See p. 22.)

## RECOMMENDATIONS

GAO recommends that the Secretary of Defense require the Director of the Defense Productivity Program Office to evaluate the relative merits of all capital investment incentive programs for which it has responsibility to determine whether or not resources needed to ensure proper program implementation and guidance can be made available to the Productivity Enhancing Incentive Fund Program. If needed resources cannot be found within the Defense Productivity Program Office, the Secretary of Defense should consider other alternatives such as reallocating resources from other programs, hiring additional personnel, or terminating the Fund program.

GAO also recommends that the Secretaries of the Air Force and Army take action to enhance the credibility of the program by

- establishing a system of independent, onsite postaudits to validate savings achieved, and
- submitting the reports that are required as part of the budget process, stating where savings have been realized and applied. (See p. 16.)

GAO further recommends that the Secretary of the Navy request no additional money for the Fund program until an action plan for improving the program is developed and then reviewed and approved by the Secretary of Defense. The plan should provide for (1) application of sufficient management resources to promote and support the program at an adequate level and ensure that only valid and supportable projects are approved, (2) revision of Navy guidance for the program to ensure compliance with Defense and congressional requirements, and (3) establishment of a system of independent, onsite postaudits of selected projects. (See p. 22.)

## AGENCY COMMENTS AND OUR EVALUATION

The Department of Defense did not agree that the program management responsibilities of the Defense Secretary had been inadequately fulfilled. The Department believes it was not necessarily inappropriate that all planned improvements were not achieved as originally scheduled. Many of

the program implementation and management activities were done as part of the Defense Secretary's efforts to coordinate the Productivity Enhancing Incentive Fund with a group of other similar programs. Defense pointed out that to properly provide a range of productivity enhancing capital investment programs, the programs should be managed in concert with one another. Consequently, certain milestones in the implementation action plan were adjusted with good reason.

GAO agrees with the Department on the need to coordinate similar programs. However, GAO does not agree that in doing so the Office of the Secretary of Defense has adequately fulfilled its management responsibilities, because certain efforts should not have been delayed. For example, problems in the Navy's program could have been detected by Defense Secretary review and oversight. Although such review and oversight were included in the action plan Defense provided to the Congress, they have not been adequately carried out.

The Department of Defense agreed with GAO's conclusions and recommendations regarding program management by the Air Force, Army, and Navy. After reviewing GAO's draft report, all three services expressed the intention to make the recommended improvements.



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ABBREVIATIONS

DOD	Department of Defense
GAO	General Accounting Office
OSD	Office of the Secretary of Defense
PEIF	Productivity Enhancing Incentive Fund

## CHAPTER 1

### INTRODUCTION

In recent years, the productivity of the American economy has become a matter of national concern. Although increases in our standard of living are largely dependent on increased national productivity, American industry has been experiencing a decline in the rate of productivity growth.

Leading economists have stated that capital investment and technological improvements afford the potential for improving productivity. It has been estimated that these two factors contribute from 40 to 60 percent of industry's growth in productivity and could also contribute significantly to the Federal Government's productivity. But several studies in the 1970s indicated that the full potential of capital investment programs was not being realized in the Federal Government. Among the reasons given for this were a lack of available funds and the long approval leadtime associated with the annual budget review processes.

To lessen these obstacles to productivity growth and permit the acquisition of relatively low-cost capital equipment that can enhance productivity, some Department of Defense components established special programs to finance such equipment. Three major categories of programs are now available to fund equipment that will provide sufficient savings to return the investment within 4 years:

- Industrial funding. Industrially funded activities such as naval shipyards can purchase productivity enhancing equipment from their operating funds.
- Set-aside funding. A portion of an agency's regular procurement funds are allocated solely for productivity enhancing investments.
- Special funding. Productivity enhancing investment funds are specifically approved by the Congress for this purpose only.

### HISTORY OF THE PRODUCTIVITY ENHANCING INCENTIVE FUND

The third funding alternative noted above was begun in the Department of Defense in fiscal 1977. In that year, the Congress provided \$19.3 million for productivity enhancing capital investments of small dollar value. The Defense criteria for the program require that each investment pay back its cost in 2 years or less. Under this new program, now known as the Productivity Enhancing Incentive Fund (PEIF), funds were not perpetuated by using the savings from the investments they financed. Instead, savings were to be used to reduce personnel, operating, and maintenance

budgets. Field managers, however, were allowed to share in savings by using them to finance other valid requirements that were not funded.

In its fiscal 1978 budget submission, Defense components requested \$27.1 million for the fast payback program, but none was approved. Funding was denied because of congressional concern that since investment projects were not preidentified, the program circumvented the normal executive and congressional budget justification process.

In 1978, our office issued a report 1/ based on a review of the fiscal 1977 fast payback program. In that report, we concluded that the basic concept of the program was sound and should be supported. However, we also concluded that a number of management improvements were needed for the program to achieve its full potential.

The Congress reinstated the PEIF program for fiscal 1979 by providing \$13.5 million. But authorization to use the funds was reserved until specific guidance established by the House Appropriations Committee was followed by the Office of the Secretary of Defense (OSD). The guidance required that (1) the program be used for projects costing less than \$40,000, 2/ (2) certain information on plans and evaluation methodology be submitted to the Committee, and (3) savings realized each year be reported in the Department's annual budget submission. Further details are identified in appendix I.

Responding on November 11, 1978, to the guidance, OSD issued an action plan for improving PEIF program operation and interim guidelines for the services to use in reinitiating the program.

The PEIF program has continued since fiscal 1979. In fiscal 1980, the Congress approved \$10.6 million for the program and Defense components have requested \$11.2 million for fiscal 1981. A summary of past and projected funding for the program is shown in the following table.

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1/"Full Potential to Achieve Savings by Investing in Fast Payback Productivity Enhancing Capital Equipment Not Realized" (FGMSD-78-44, July 25, 1978).

2/Limit changed to \$100,000 in Sept. 1979.

<u>Component</u>	<u>Approved funding amount</u>				<u>Requested for 1981</u>
	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	
	----- (millions) -----				
Army	\$6.1	\$ -	\$5.9	\$3.0	\$3.0
Navy	6.7	-	3.0	3.0	3.2
Air Force	6.5	-	3.6	3.8	4.3
Defense Logistics Agency	-	-	1.0	0.8	0.7
Total	<u>\$19.3</u>	<u>\$ -</u>	<u>\$13.5</u>	<u>\$10.6</u>	<u>\$11.2</u>

### PROGRAM MANAGEMENT RESPONSIBILITIES

PEIF program management is conducted in concert with other capital investment programs. The Defense management approach is to develop and promote an overall productivity enhancing capital investment strategy. OSD and the services consider the relative size of these programs in providing needed management to individual programs. The PEIF program is small compared to other similar programs. For example, Defense's Productivity Investment Fund program included 27 competitively selected projects totaling over \$60 million.

Responsibility for PEIF program management is divided between OSD and the services. OSD provides overall direction and guidance, monitors the services' execution of the program, and prepares the annual report to the Congress on program results. This responsibility is assigned to the Defense Productivity Program Office. The individual services are responsible for requesting PEIF appropriations in their annual budget requests; developing detailed program management procedures in line with OSD's general guidance; and identifying, justifying, reviewing, approving, and postauditing the actual PEIF projects. In the Army and the Navy, PEIF program management responsibility rests in the comptroller organizations. In the Air Force, PEIF management responsibility is assigned to the Air Force Management Engineering Agency.

### OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to follow up on our 1978 report which recommended several ways to improve PEIF program management. Specifically, our review reevaluated the management of the program and the results achieved since it was reinitiated in fiscal 1979. We also assessed implementation of congressional guidance for the program.

To accomplish our objective, we (1) interviewed program managers at OSD and at the headquarters level of Air Force, Army, and Navy, (2) reviewed instructions, operating procedures, and other guidance and documentation relating to the PEIF program, and (3) visited several field commands of the services to see how the program was being implemented at those levels. Also, to test the overall quality of PEIF project justifications and review, to assess compliance with program criteria, and to review actual results from program investments, we selected and reviewed 10 Air Force, 10 Army, and 13 Navy PEIF projects approved in fiscal 1979.

For each of these projects, we performed a detailed, onsite audit including an examination of the project's justification and supporting documentation. For those projects that were operational, we evaluated the actual savings being realized. Although we selected the projects primarily because of their geographic proximity to the GAO offices that performed the work, we have no reason to believe they are not representative of all fiscal 1979 projects. The number of projects reviewed represents 11.4 percent of the total number of Air Force projects approved in fiscal 1979, 4.2 percent of the Army's, and 13.0 percent of the Navy's. Appendix II lists the activities we visited during the review.

## CHAPTER 2

### OFFICE OF THE SECRETARY OF DEFENSE

#### IMPLEMENTATION OF PLANNED IMPROVEMENTS

##### HAS BEEN SLOW

The Congress has given the Office of the Secretary of Defense the responsibility for PEIF program oversight and guidance. In discharging these responsibilities, OSD has taken positive steps to improve program management and ensure compliance with congressional guidance. However, OSD progress in implementing many planned improvements has been slow. Consequently, shortcomings in the management of the program continue to exist and full compliance with congressional guidance has yet to be achieved. Additional steps are needed for the program to realize its full potential.

##### MOST ACTION PLAN MILESTONES WERE NOT MET OR WERE MET LATE

Responding on November 11, 1978, to congressional guidance, OSD's Defense Productivity Program Office issued an action plan consisting of objectives, goals, and milestones for improving PEIF program operation and management. Also on that date, to help ensure service compliance with the congressional requirements, OSD issued interim guidelines for the services to use in reinitiating the program. This guidance covered project selection priorities, postaudits, and documentation and reporting requirements. In addition to providing the framework for complying with congressional requirements, OSD's action plan and interim guidelines for improving the PEIF program also incorporated the essence of most of the conclusions and recommendations made in our 1978 report. These conclusions and recommendations are summarized in appendix I. They focus on the need to promote the program, soundly justify proposed investments, and conduct independent postaudits.

Had OSD's action plan been successfully implemented on schedule and had OSD ensured full service compliance with the interim guidelines, we believe the PEIF program would have quickly gained credibility and proved that the benefits the Congress desired to see are achievable. However, this has not been the case. Since November 1978, most of the milestones in the action plan have not been met or were met far behind schedule.

To illustrate, one milestone step in the action plan called for OSD to formalize the interim guidelines by December 1978 by issuing a new instruction. Although drafts of this new instruction were prepared and circulated among the services for comment, the final instruction was not issued until December 1980, 24 months after the milestone date.

We learned from OSD officials that other important milestones in monitoring the services' implementation of program improvements and ensuring full service compliance with congressional and OSD guidelines also have not been met. For example, by June 1979, OSD planned to (1) review service implementing instructions for the fiscal 1979 program, (2) review selected project justifications, and (3) conduct onsite appraisals of program operations. As of September 1980, however, none of these planned actions had been accomplished. The following summarizes OSD's performance in completing the milestone steps in the action plan:

Milestone steps in action plan	15
Steps scheduled to be completed by September 1980	13
Steps completed on schedule	4
Steps completed but behind schedule	2
Steps behind schedule and not yet completed in September 1980	7

Reasons for slow progress

According to OSD officials, two factors contributed to OSD's slow pace in implementing its action plan for improved PEIF operation. First, in 1979 OSD decided to delay issuing final guidelines to the services until the guidelines for the full range of productivity enhancing capital investment programs could be issued as a single instruction. As noted earlier, this final instruction was issued in December 1980, 24 months after the milestone date. However, had the services complied with OSD's interim instructions, we believe the impact of this delay on program operation would have been minimal.

Secondly, OSD is involved in the management of other productivity enhancing capital investment programs. OSD officials told us they allocate staff and other resources to these programs in direct proportion to each program's respective costs and expected benefits. For example, during 1979 the OSD productivity staff, consisting of only six professionals, devoted much of its effort to developing a major new productivity improvement program. This new program, the OSD productivity investment "set-aside" program, was approved for fiscal 1981 and involves \$64.3 million, or almost five times as much as the PEIF program. Because of its size, and because OSD plays a more significant role in the program, OSD has placed greater priority on the "set-aside" program than on the PEIF program.

Full implementation of program requirements  
by military services has also been slow

Even though OSD did not effectively implement its action plans, there would have been little effect if the services had moved ahead with their own programs and complied with congressional guidance. This is true because the individual services--not OSD--are



responsible for managing the PEIF program, including the identification, justification, review, approval, and auditing of investment projects. Further, the interim OSD guidelines, which contained the congressional requirements, were provided to the services.

But this has not happened. For example, although the Air Force and the Army have improved the management of their PEIF programs and are achieving significant benefits, neither has fully met the requirement for postaudit of investment projects and identification in each year's budget of where program savings have been realized and applied. The Air Force and Army programs are discussed in greater detail in the next chapter.

In the Navy, the situation is much worse. For example, the Navy has failed to devote the management resources and emphasis needed to establish a reasonably successful and effective program. As a result, most of the Navy projects we reviewed were unsupported. The Navy has also failed to fully implement important congressional and OSD requirements for the PEIF program. These matters are discussed in detail in chapter 4.

#### CONCLUSIONS AND RECOMMENDATIONS

The Congress has mandated the PEIF program to the services and has required that OSD promote and provide oversight to the program. However, OSD has not applied sufficient resources to do this. We recognize that budget restrictions necessitate careful evaluation by OSD in its allocations to competing programs, and we are aware that other similar capital investment programs that are larger in size and scope can demand greater attention. However, unless the PEIF program is properly conducted, capital investment funds can be wasted. Therefore, we recommend that the Secretary of Defense require the Director of the Defense Productivity Program Office to evaluate the relative merits of all capital investment incentive programs for which it has responsibility to determine whether or not resources needed to ensure proper program implementation and guidance can be made available to the PEIF program. If needed resources cannot be found within the Defense Productivity Program Office, the Secretary of Defense should consider other alternatives such as reallocating resources from other programs, hiring additional personnel, or terminating the PEIF program.

#### AGENCY COMMENTS AND OUR EVALUATION

In reviewing our draft report, the Department of Defense provided general comments on our presentation of the OSD management role and specific comments on the conclusions and recommendations of each chapter. Appendix III is a copy of Defense's comment letter. The general comments are in the cover letter transmitting the chapter-by-chapter analysis of our draft report. These general comments relate primarily to this chapter, and can be summarized as follows:

--The Department of Defense disagreed with our conclusion regarding OSD's inadequate program guidance, and stated that OSD has applied sufficient resources to the PEIF program and has provided adequate program guidance and promotion. For example, Defense stated that the interim guidance was sufficient to get the program reinitiated. It believes that the intent of the implementation plan sent to the Congress is substantially being met, although not timed precisely as cited in the plan. Defense does acknowledge that service compliance with the OSD guidance has not been as complete as it should be.

--Defense stated that continuing guidance to services is being provided within resource constraints and the remaining steps of the implementation plan will be performed this summer. The remaining steps focus primarily on establishing oversight activities, which include program reviews and reviews of services' implementing instructions.

--Defense complained that the report does not place the PEIF program in perspective with other capital investment programs. On the one hand, OSD efforts on these various investment programs are often interrelated and sometimes apply generally to all programs. On the other, resources and efforts applied uniquely to each program are done so in direct proportion to each program's respective costs and expected benefits. In this regard, Defense took the position that it was appropriate to delay issuing final PEIF program guidance until a consolidated set of instructions for all productivity enhancing capital investment programs could be developed.

As we discussed in chapter 1, the Congress reinstated PEIF program funding with the requirement that program management be improved. OSD responded by providing the Congress with an action plan consisting of objectives, goals, and milestones for improving program management. Since the achievement of the action plan is central to program management credibility, one of the key issues discussed in this report must be how well the plan's milestones have been met.

OSD has been slow in meeting these milestones. This slowness on OSD's part did not appear to significantly affect the Army and Air Force programs, as those services successfully managed with interim guidance. Therefore, there is some merit to OSD's position that its interim guidance was adequate to get the program underway, and that final guidance could wait until a consolidated package could be issued for all productivity enhancing capital investment programs. However, the lack of OSD review of the services' implementing instructions and selected justifications and of onsite reviews are logical factors in the substantial lack of Navy implementing instructions and in related problems of the Navy program. These problems are discussed further in chapter 4.

Consequently, we do not agree with OSD's contention that adequate resources were applied to completing the action plan and overseeing the services' programs.

Defense also pointed out that the proposed position in our draft report that the Congress lift the program mandate if sufficient resources for oversight and guidance to the services could not be assured, was inappropriate considering the success the Air Force and Army have had with the program. We believe the point is well taken, and we are recommending that various alternatives be considered for obtaining necessary resources to provide adequate oversight of the Air Force and Army programs, and to monitor and guide implementation of the Navy program.

In addition to its comments on our conclusions and recommendations, Defense identified two areas needing clarification. To clarify the first, we have added information in the section on reasons for slow progress. It now reflects that the OSD staff is involved in more than one other productivity enhancing capital investment program. Defense stated we should not imply that most of OSD's staff time was spent on a single, larger capital investment program.

To clarify the second, we have added information related to other productivity enhancing investment programs in chapter 1 and in this chapter. Defense officials expressed concern that the range of productivity capital programs was not sufficiently explained.

Finally, Defense pointed out that our report failed to mention the onsite review of service programs being conducted by the Defense Audit Service. The Audit Service contacted us prior to initiating its work in the productivity enhancing capital investment fund area. Because we were reviewing the PEIF program, the Audit Service has confined its audit to other programs.

## CHAPTER 3

### AIR FORCE AND ARMY ARE ACHIEVING

#### SAVINGS THROUGH PEIF PROGRAM

The Air Force and the Army have devoted the management resources and attention needed to establish a profitable PEIF program. As a result, many of their program investments have increased productivity and reduced costs--demonstrating again the potential of the program. For example, 12 Air Force and Army projects we reviewed should save over \$1.7 million in the first 5 years of operation in return for the \$240,000 investment cost. However, to fully meet congressional and OSD requirements for the PEIF program, the services need to improve their efforts in post-investment auditing and in reporting realized savings in their annual budgets.

#### PEIF PROGRAM IS RECEIVING MANAGEMENT EMPHASIS

The success of any productivity enhancing capital investment program depends upon interested, aggressive management. Only through strong management emphasis can a fast payback program be promoted at all levels to ensure that worthwhile investment projects are identified and quickly financed and installed.

Recognizing this, the Air Force and the Army have emphasized the PEIF program and devoted sufficient management resources to support their programs. For example, the Air Force has two full-time managers who are responsible for the PEIF program throughout the Air Force. In addition to providing overall guidance and direction for the program, the managers promote PEIF at all command levels through presentations, literature, and informal discussions about how the program works and its benefits. Also, from their servicewide perspective, these managers provide the final review and approval of all Air Force investment proposals.

In the Army, these functions are performed by one full-time manager who is also responsible for two other Army productivity programs. However, we were told that the Army plans to add another full-time manager for these programs in the near future.

In addition to the full-time managers, the Air Force and the Army have part-time PEIF program coordinators at subordinate command levels who help in project identification, justification, and review.

#### Idea interchange program

Another indication of Air Force and Army emphasis on PEIF programs is the existence of viable idea interchange programs. To promote project identification and the transfer of good investment ideas from one activity to another, the Air Force and the Army have

each established a program for exchanging beneficial ideas. These promotion programs are conducted within the services since OSD has broader promotion responsibility.

The Air Force program works via a quarterly newsletter sent to all major Air Force commands. Prepared by the Air Force Management Engineering Agency, the newsletter discusses ways local commands can promote the program and encourage identification of worthy investment ideas. It includes a listing of all approved PEIF projects so local commands can determine whether the projects are potentially useful in their commands.

Similarly, the Army's idea interchange program, initiated in May 1980, requires major commands, installations, and activities to surface and circulate proven productivity enhancing ideas throughout their organizations. In addition, starting in September 1980, Army headquarters was to begin collecting and disseminating throughout the service proven investment ideas which have potential for wide application.

#### Rapid review, financing, and installation

One of the goals of the PEIF program is to provide a mechanism that allows worthy productivity enhancing investment ideas to be quickly financed and installed. By placing management emphasis on the PEIF program, the Air Force and the Army have largely achieved this goal by reviewing, funding, and installing investment projects in a relatively short time. For example, for the 10 Air Force projects we reviewed, the average time between project identification and approval for financing was only 2.5 months. One of these projects for electronic cash registers with projected annual savings of \$72,800 was justified, reviewed, and approved for financing only 1 month after it was identified, and was procured and installed in 2.5 months. Under the normal budgeting cycle, this project probably would have waited at least 2 years for financing, procurement, and installation.

The 10 Army projects we reviewed also achieved quick financing under the PEIF program. For the 10 projects the average time between identification and approval for financing was 4.6 months, and the average time from approval dates to contract award dates was only 2.7 months. Three of these projects, involving a steam cleaner, word processing equipment, and an automated vehicle lift, were identified, justified, reviewed, and approved within only 76 days.

Reducing the time between project identification and installation from the normal 2 or more years to less than 1 year under the PEIF program provides two benefits. First, since cost saving projects are installed quicker, their savings begin to accrue sooner. Secondly, the people who identify project proposals see their ideas implemented sooner. This usually acts as a motivator to the employees and encourages further effort to identify productivity enhancing investments.

PROJECTS ARE DEMONSTRATING  
BENEFITS OF PEIF PROGRAM

Because management emphasizes and supports their PEIF programs, the Air Force and the Army have already realized significant benefits from their investment projects, demonstrating again the potential of the program. For example, we reviewed 10 Air Force and 10 Army PEIF projects, costing \$129,000 and \$239,500 respectively, that were approved for the fiscal 1979 program. Of the 10 Air Force projects, we found that 9 were well supported, met program criteria, and achieved significant benefits. For the first 5 years these nine projects are operational, they should save the Government \$1,325,000 in return for their \$109,000 cost--about \$12 for each \$1 invested. And some of these projects should continue producing savings for 10 to 20 years.

The following examples highlight four of the Air Force projects:

- A base photography laboratory acquired an automatic film processor for \$7,700, which will save \$12,000 annually and pay back the investment in 8 months by reducing the need for one laboratory worker.
- A clerical office project costing \$24,800 involved an electronic typing system which increases productivity and raises the quality of products. The system saves \$16,500 annually and will pay back the investment in 18 months by eliminating the need for a full-time typist.
- By purchasing electronic cash registers for \$8,700, a base dining hall was able to switch to an a la carte serving and pricing system. Under this system, personnel take only the items wanted; as a result, less food is wasted. During the first 6 months the registers were used, over \$36,000 was saved in food costs.
- To control access to a classified work area while eliminating the need for security guards, an automatic card-key access system was acquired at one activity. The project's \$11,200 cost will result in annual labor savings of over \$34,000.

In the Army, only 3 of the 10 projects we reviewed were completely supportable and valid. These projects should pay back in less than 2 years; within 5 years they should save \$391,100 in return for the \$129,300 investment. One of the projects, for example, was a \$16,300 word processing system at a training facility. By increasing productivity, the system was able to perform the required workload while eliminating the need for three temporary employees. The project will save about \$15,100 annually and pay back the investment in 13 months.

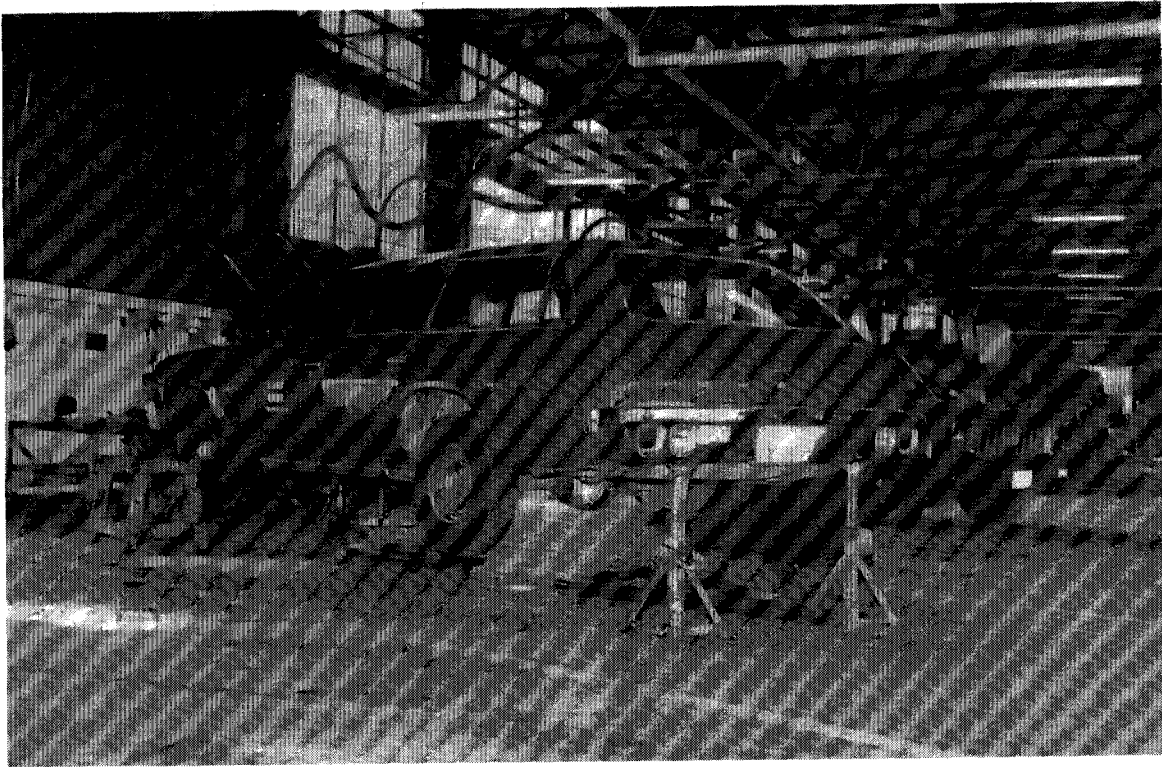
Two of the Army projects we reviewed should not have been approved because they did not meet all critical program criteria. Specifically, Defense criteria require that the services determine if new or proposed methods and procedures can be accomplished using existing equipment. In these two cases, no such determination was made and the new equipment was not required to obtain the savings. For the remaining five projects, we were unable to determine whether program criteria were met because various costs were not considered or supporting documentation was not available. However, this does not mean that they do not meet program criteria and will not pay back the investment within 2 years. It simply means that detailed documentation supporting the projects' justifications was not available to substantiate the cost and savings estimates used in the analyses. For example, one project we reviewed involved the purchase of hydraulic vehicle lifts for a vehicle maintenance activity. The lifts were justified on the basis that they would save labor that had been used to manually jack up vehicles for maintenance. (See photographs on page 14.) While the \$20,900 project appears worthy, documentation was not available to support the assumptions made and the factors used to arrive at the estimated savings. For instance, the activity that proposed the justification had no copies of the old work requests which were used to estimate future usage of the lifts, and no information was available to support estimates of how much time the lifts could save.

Although the Army PEIF projects we reviewed were not as well documented or as successful as the Air Force projects, we believe that the planned addition of another full-time manager to Army's productivity programs should help improve Army's review of future project justifications for validity and supportability.

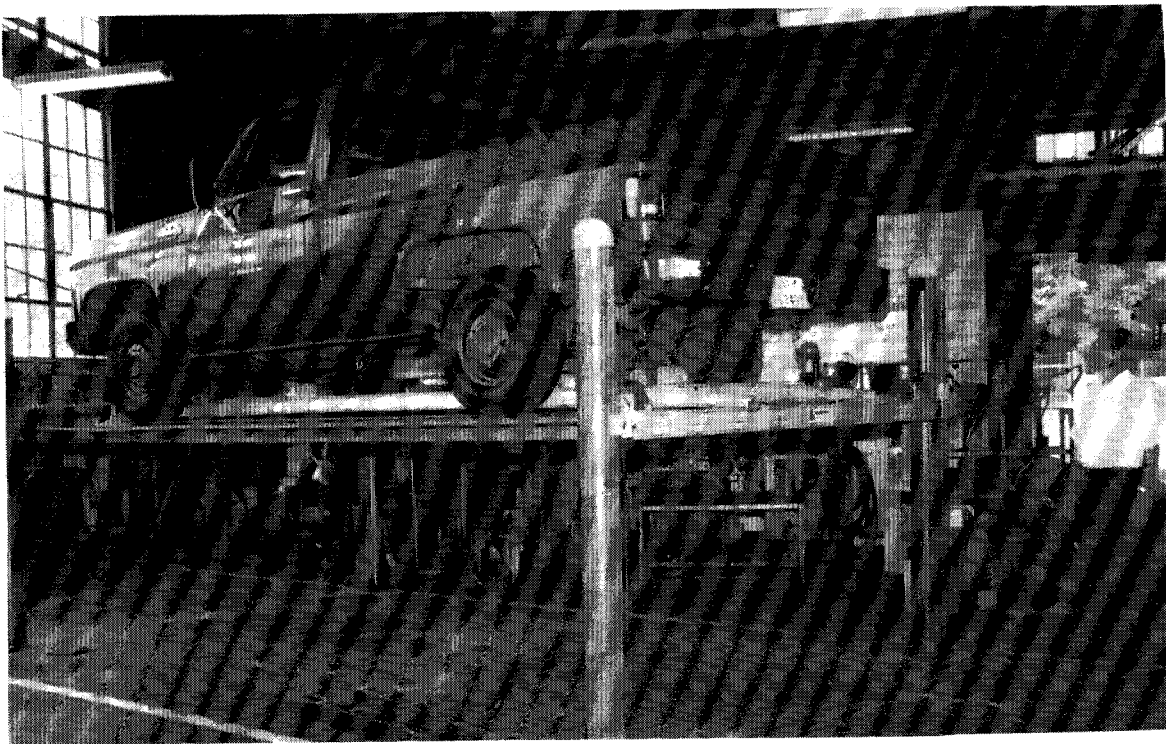
POSTAUDITING AND REPORTING  
REQUIRES ADDITIONAL ATTENTION

Followup evaluation of capital investments serves as a check on whether the planned benefits are being realized after purchased equipment becomes operational. Information provided by postaudits can be an effective tool for managing capital expenditures, for demonstrating program credibility, and for identifying corrective action needed to realize the full potential of investments.

The fiscal 1979 congressional guidance for the PEIF program, as well as subsequent OSD guidance, requires that postaudits be performed and that audit results be summarized and provided to the Congress annually. In addition, the congressional guidance requires that Defense show in each year's budget submission where savings have been realized from the program and where the savings have been applied. At the time of our review, the Air Force and the Army had performed no onsite postevaluations of their fiscal 1979 investment projects. Neither service had begun reporting realized savings in their annual budget submissions.



**MANUAL JACK USED ORIGINALLY.**



**HYDRAULIC JACK INSTALLED AS PEIF PROJECT.**



## Monitoring efforts for installed projects

Although the Air Force had performed no onsite audits for installed PEIF projects, it had instituted a monitoring system which it feels complies with the intent of the congressional and OSD guidance. This system requires activities to report actual savings on installed investments every 180 days. These monitoring reports are prepared at the activity level by the group that prepared the original project justification and are then submitted to the Air Force Management Engineering Agency for review.

We reviewed eight Air Force projects that were installed and operational. In each case, the responsible activity was maintaining data that could be used to prepare an accurate followup report. Seven of these projects had been installed long enough that at least one report had been submitted. Our analysis showed the reports were complete and accurate.

While the Air Force monitoring system provides management with needed feedback on installed projects, we believe that independent, onsite audits are needed at least on a sample basis to fully meet the congressional and OSD requirements and enhance program credibility by assuring the validity of the claimed savings.

The Army also has a monitoring system that requires activities to periodically report actual savings on installed PEIF projects. However, the system does not include provisions for onsite audits and some activities we visited were not complying with the requirement to submit monitoring reports. For example, although initial monitoring reports are required within 6 months of project installation, no reports had been completed for three projects we reviewed that had been installed for over 6 months. Also, for two other projects installed for less than 6 months, information needed to complete the monitoring reports was not being collected. Management at the activities responsible for these projects told us they were unaware of the reporting requirements and had not been maintaining the necessary data to support such a report.

## Reporting savings in budget submissions

Neither the Air Force nor the Army has yet reported realized savings in its annual budget submission as required by congressional criteria. We were told by an OSD official that this information will be included in the Air Force's and Army's fiscal 1982 budget submissions. However, we believe that without independent postaudits of the projects the validity of any reported savings is questionable. As long as the amount of actual savings achieved is in question, the credibility of the overall program cannot be fully established.

## CONCLUSIONS AND RECOMMENDATION

We believe that the Air Force and the Army have applied the management emphasis necessary to support the PEIF program and have achieved considerable success. Although the Army projects we reviewed were not as well supported as the Air Force projects, we believe the Army has the necessary management framework in place to improve its program in the future.

We also believe that to fully meet congressional and OSD requirements for the PEIF program, the Air Force and the Army need to improve their efforts in postauditing. The best way to enhance the program's credibility and encourage interest is to demonstrate that significant savings can be achieved and report such savings to the Congress as part of the annual budget submission.

Until a decision can be made by OSD about the future of the PEIF program, we recommend that the Secretaries of the Air Force and Army take action to enhance the program's credibility by

- establishing a system of independent, onsite postaudits to validate savings achieved and
- submitting, as part of the budget process, the required reports on where savings have been realized and applied.

## AGENCY COMMENTS AND OUR EVALUATION

The Department of Defense agreed with our recommendations and advised that the Air Force and Army will comply and include the recommended actions as an inherent part of their program. However, Defense pointed out that some audits of the PEIF program were conducted by both the Air Force and the Army.

We were aware of the audits performed by the Air Force and Army and investigated them as part of our review. The Air Force audits were not onsite, independent examinations of equipment and basic cost and workload data. The Army audits were not conducted by organizations that were independent of the equipment justification and review process. Hence, neither the Air Force nor the Army audits can be considered independent audits that conform to the intent of OSD and congressional guidance. Both services apparently recognize this since they both expressed agreement with our recommendation.

## CHAPTER 4

### THE NAVY'S INCENTIVE FUND PROGRAM

#### MANAGEMENT NEEDS IMPROVEMENT

In contrast to the Air Force and the Army, the Navy has not devoted the management resources and emphasis necessary to adequately support its PEIF program. During our review, we found that the Navy's PEIF program is not being actively promoted, Navy guidance does not fully comply with OSD requirements, there are extensive delays between project identification and installation, the justifications for many approved projects are invalid or unsupported, and postaudits are practically nonexistent. As a result, we believe the Navy is unable to demonstrate that its PEIF program has been successful and recommend that it be discontinued until significant improvements to program management are implemented.

#### PEIF PROGRAM LACKS MANAGEMENT EMPHASIS AND RESOURCES

In the preceding chapter, we noted that for a fast payback program to be successful, management must be interested and aggressive. In addition, sufficient management resources must be applied to ensure that worthy projects are identified and quickly financed and installed. Unfortunately this has not been the case in the Navy, where only minimal attention and management effort have been devoted to the PEIF program.

For example, at the headquarters level only one person has been designated to work on the Navy's PEIF program. This manager told us that his responsibility for managing the PEIF program is a collateral duty to be performed in addition to his normal job duties. Although he is responsible for promoting the program Navy-wide, reviewing the justifications for all proposed investments, and giving the Navy's final approval for project financing, he estimated that he spent less than 5 percent of his time on the program.

Similarly, at the intermediate command level only limited management resources were devoted to the PEIF program. Each command we visited had assigned PEIF responsibilities to only one person and in each case the PEIF responsibilities were added as a collateral duty. These managers estimated that they spent less than 10 percent of their time on the program even though their duties included program promotion and review of project proposals. One manager admitted that he spent so little time on the program he was unfamiliar with even the basic Navy and OSD guidelines for the PEIF program.

### Navy guidance does not comply with OSD requirements

Another example of limited emphasis on the PEIF program has been the Navy's failure to update its PEIF operating instructions to comply with OSD and congressional requirements for the fiscal 1979 program. Although OSD issued its interim guidelines on November 11, 1978, the Navy had not fully incorporated these requirements into its PEIF instructions at the time of our review in August 1980. An April 1977 instruction was being used as guidance for PEIF program management. As a result, the Navy's guidance is inconsistent with OSD's in that the Navy guidelines do not

- include an order of priorities for choosing which proposed projects should be funded,
- require that, prior to approval, project proposals and justifications be reviewed by an organization other than the submitting unit or activity,
- require periodic reporting of project progress after installation, or
- require documentation of the disposition of project savings.

### Minimal program promotion

A further indication of limited PEIF program emphasis is the Navy's failure to actively promote project identification. For example, rather than promoting the PEIF program and encouraging submission of investment ideas throughout the year as is done by the Air Force and Army, Naval commands we visited usually requested local activities to submit investment proposals only once a year during the normal budget formulation. A representative of one of these local activities we visited said they did not receive the customary request for PEIF projects for fiscal 1980. Consequently, the activity submitted no investment proposals because it thought no money was available for the program.

Also, unlike the Air Force and the Army, the Navy has not established a Navy-wide idea interchange program. Thus, the Navy has no formal system for transferring good investment ideas with potential for wide application from one activity to another.

### Excessive delays in project financing

Excessive delays in the project approval, contracting, and installation process is yet another indication of limited Navy support for the PEIF program. Although one goal of the program is to allow rapid financing and installation of worthy productivity enhancing investment proposals, the Navy's PEIF program often requires as much time as the normal budget process for

project approval, contracting, and installation. For example, for the 13 Navy projects we reviewed, the average time between project identification and approval for financing was 15 months as compared with an average of 3.5 months for Air Force and Army projects. Three of the Navy projects were not approved for financing until 2 years after they were identified and justified.

One of the reasons for the delay in approval was that the Navy did not review and approve projects as they were submitted during fiscal 1979. Instead, projects were held until the latter part of the fiscal year and then all approved on the same day. In addition to defeating the goal of rapid financing, this procedure may have created additional delays in contracting, since all projects were forwarded to contract offices at approximately the same time. To illustrate, the 13 projects we reviewed were all approved for financing on July 9, 1979. By August 1980, 13 months after approval, seven of these projects had not yet been contracted for. Overall, only five of the projects we reviewed were installed and operating at the time of our review.

Although our review was restricted to the fiscal 1979 program, we found one project from the fiscal 1977 PEIF program that also illustrates the extensive delays in the Navy's program. This project was a \$28,000 hydraulic test bench for a maintenance activity which, according to its justification, would save about \$42,000 annually by reducing the cost to repair hydraulic ship parts. The Navy approved the project for financing in December 1976. At the time of our visit to the activity in September 1980, the machine was not installed and operating. Instead, we found the machine still in its shipping crate and were told that installation was delayed because building modifications required before installation had not been completed. No required building modifications were indicated in the original justification.

MANY PROJECT JUSTIFICATIONS ARE INVALID  
OR INSUPPORTABLE

Apparently, because the Navy has not devoted the management resources and emphasis needed to fully support its PEIF program, most of the fiscal 1979 projects we examined were not adequately reviewed before they were approved. As a result, most of the project justifications we reviewed were inaccurate, invalid, or insupportable; consequently, most projects will neither increase productivity nor reduce operating costs.

We reviewed the justifications for 13 of the Navy's 100 PEIF projects that were approved as of October 1980 for the fiscal 1979 program. Of the 13 project justifications, only one was completely valid and supportable. This project, an automated supply parts retrieval system for a supply facility, should pay back its cost within 14 months by reducing the need for personnel.

For the other 12 projects we reviewed, we found significant omissions in the justifications. For example, seven lacked the

documentation to substantiate cost and savings estimates used in the analyses, and five were invalid because the investments as proposed would neither increase productivity nor reduce costs. Also, of the 12 justifications, six contained simple mathematical errors in their economic analyses which should have been detected by even a cursory review.

In most cases, the project justifications we examined were not adequately reviewed prior to approval. For example, the commands we visited did not verify the validity of data in the justifications, or examine supporting documentation. Representatives at these commands told us that they relied on the integrity of each submitting activity's management to ensure that only accurate and valid proposals are submitted.

Some project reviewers also failed to reevaluate investment justifications when the estimated cost of a project increased substantially. For example, one justification we reviewed for a cable tester estimated the project would cost \$5,200 and in 2 years would save \$11,000. However, at the time of our visit the cost of the item had increased to \$13,800. Although the increased cost of the project clearly indicated that it would no longer pay for itself within the 2-year limit, no one reevaluated the project to see if estimated savings had also increased so that the purchase could still be made under the PEIF program.

The following examples highlight some of the problems in the justifications we examined and further demonstrate the inadequacy of the Navy's review of investment proposals.

--A \$4,500 sheet metal forming machine at a maintenance activity was justified on the basis that it would automate a process which had been done manually. In fact, it was replacing an older machine just like itself. The activity was unable to support any expectation of increased productivity or reduced operating costs that might result from the project.

--A justification for a \$12,700 lathe at a maintenance activity indicated that the project would save \$9,500 a year by reducing contracting costs. Navy officials had no documentation showing that any contracting costs had been incurred due to a lack of lathes. In addition, since this lathe was a replacement for an older model, we believe that the project is unlikely to improve productivity.

--A justification for laboratory test equipment at a supply facility indicated a 13-month payback would be achieved by increasing the laboratory's output. However, we found that the justification was based on the equipment's capacity, not actual laboratory workload, which was considerably less. In addition, this equipment simply replaced older equipment and thus will not increase productivity.

--A justification for a \$32,000 swage press was approved for financing on July 9, 1979. The project was justified on the basis that it would save \$84,800 annually by reducing contracting costs. When we visited the activity, we found not only that no contracting costs had been incurred, but that the activity had received a surplus swage press from another activity in 1977 and had no need for a new one.

Although the swage press project and two other projects which we concluded were invalid had been approved for financing, they had not been contracted for at the time of our audit. When we discussed our findings with Navy representatives, they agreed with our conclusions on these projects and subsequently canceled their pending procurement. This action saved \$36,000.

PROGRAM CREDIBILITY IS BEING FURTHER WEAKENED  
BY LACK OF POSTAUDITING AND REPORTING

As we noted in the preceding chapter, an effective postauditing system can be a valuable tool for managing capital expenditures, for demonstrating program credibility, and for identifying corrective action needed to realize the full potential of investments. The Navy, however, has not implemented an adequate system to audit and report on installed investment projects. In addition, since some activities have not maintained savings data on their PEIF projects, the Navy is not able to accurately report in annual budget submissions where project savings have been applied.

The Navy's postauditing system

The Navy's PEIF program instructions require activities to complete a postaudit report on each project within 2 years of its installation date. Periodic progress reports showing accrued savings are not required. The one biannual report is to be completed by the same activity that prepared each project's initial justification. Independent, onsite audits are not required.

In our opinion, this system of postevaluation is unsatisfactory for several reasons. One is that the Navy's system does not comply with OSD guidelines requiring the services to report PEIF savings periodically. Since no progress information is reported for 2 years, management loses the opportunity to identify projects not meeting expectations in time to take corrective action.

Another fault with the Navy's postauditing system is that it lacks the independence needed to ensure credibility. We believe that program integrity can be established only through onsite audits, at least on a sample basis, conducted by parties not involved with the initial justifications.

Revealing a further problem with the Navy's system, the Navy's PEIF manager told us he does not know when projects are

installed and therefore does not know when the 2-year postaudit reports are due. As a result, management had no way of detecting overdue reports so followup action could be initiated. Instead, the Navy's PEIF manager told us, he must rely on the activities to submit the postaudit reports when they are due. At the time of our visit in August 1980, no postaudit reports, even from the fiscal 1977 PEIF program, had been submitted.

Information not being  
maintained or reported

Some of the activities we visited were not maintaining records that could form the basis for a postaudit report on installed PEIF projects. For example, usage and savings data were being collected for only two of the five projects we examined that were installed at the time of our review. At one activity, officials who were not keeping performance information told us they were unaware of any requirement to do so.

Without the records to show actual productivity gains, and without an adequate system for postaudit, the Navy does not know if its PEIF projects are paying back the investments or where savings that may have accrued are being applied. As a result, the Navy has been unable to establish credibility for its PEIF program or comply with the congressional requirement to show in annual budget submissions where realized savings have been applied.

CONCLUSIONS AND RECOMMENDATIONS

Because of the lack of sufficient management resources and emphasis, the Navy's PEIF program has been unsuccessful, especially when compared to the Air Force and Army programs. The Navy has not actively promoted the program, has not ensured compliance with OSD criteria, has not approved and installed proposals quickly, has not adequately reviewed justifications to ensure that only valid and supportable projects are approved, and has not implemented a satisfactory system for postauditing and reporting. As a result, we believe the Navy's PEIF program lacks basic credibility and should not be continued until significant improvements to program management are implemented.

We recommend that the Secretary of the Navy request no additional funding for the PEIF program until an action plan for improving program management is developed and then reviewed and approved by the Secretary of Defense. This plan should provide for the (1) application of the management resources necessary to promote and support the program at an adequate level and to ensure that only valid and supportable projects are approved, (2) revision of Navy guidance for the program to ensure compliance with OSD and congressional requirements, and (3) establishment of a system of independent, onsite postaudits of selected projects.



## AGENCY COMMENTS AND OUR EVALUATION

Defense agreed with our recommendations, and stated that the Navy has agreed to submit an action plan to OSD for review and approval before using fiscal 1982 program funding to finance PEIF projects.

Also, in our meeting with Defense officials to discuss their proposed response to our draft report, the Navy officials outlined some of their plans. These included the essence of our recommendations and, in our opinion, indicated a very positive management commitment to improving their program.

CONGRESSIONAL AND DEPARTMENT OF DEFENSEPROGRAM GUIDANCE

The Congress required the Office of the Secretary of Defense to follow specific guidance as it reinitiated the PEIF program in fiscal 1979. The purpose of this guidance was to assure the Congress that the program would achieve credibility and successfully enhance productivity. Specifically, the congressional guidance required that:

"Appropriations provided for this program \* \* \* may only be used for projects whose cost is less than \$40,000. [1/] All other productivity enhancement projects are to be pre-identified and included in other procurement lines.

"Before obligating the fiscal year 1979 appropriation, the Department shall submit to the Committee a plan showing how projects in this program are to be evaluated and placed in priority. The plan should also show what provisions are made to assure that projects are productivity enhancing.

"Provision shall be made for post-audit of PEIC [Productivity Enhancing Capital Investment] projects and a summary of the results of these audits shall be provided to the Committee annually.

"The Department shall show in each year's budget submission where the personnel and other savings have been realized from prior year projects and show specifically where these savings have been applied." 2/

Responding on November 11, 1978, to the congressional guidance, OSD issued an action plan consisting of objectives, goals, and milestones for improving PEIF program operations and management. Also on that date, to help ensure service compliance with the congressional requirements, OSD issued interim guidelines for the services to use in reinitiating the program. These guidelines identified specific criteria for projects and requirements for preinvestment review and appraisal. The guidelines also included (1) a system of priorities to ensure that optimum productivity improvement would be the focus of the fiscal 1979 program, (2) very specific project documentation requirements to facilitate post-investment evaluation, (3) a requirement that the services establish provisions for project audits, and (4) a requirement that

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1/This limit was changed to \$100,000 in September 1979.

2/House Appropriations Committee Report 95-1398.

service headquarters maintain information that could quantify both the investments and their results.

In addition to providing the framework for complying with congressional requirements, OSD's action plan and interim guidelines for improving the PEIF program also incorporated the essence of most of the conclusions and recommendations made in our 1978 report. These conclusions and recommendations focused on the management ingredients essential to establish a credible, fast, pay-back capital investment program that would maximize potential savings and productivity enhancement. For example, in that report we concluded that for the PEIF program to achieve its full potential and have credibility, management must do the following:

- Emphasize and promote the program to ensure maximum identification of profitable investment opportunities.
- Ensure sound, detailed economic justifications for proposed investments by requiring independent review prior to approval.
- Establish a system of independent postaudits to verify and document the actual results of the investments.

OSD's interim guidelines of November 11, 1978, required the services to include most of these essential elements in their PEIF programs for fiscal 1979.

COMMANDS AND FIELD ACTIVITIES VISITED

## Department of Defense:

The Defense Productivity Program Office  
Office of the Secretary of Defense  
Washington, D.C.

## Air Force:

Headquarters, U.S. Air Force  
Washington, D.C.

Air Force Management Engineering Agency  
Randolph Air Force Base, Texas

Tactical Air Command, Langley Air Force Base  
Hampton, Virginia

Andrews Air Force Base, Maryland

Dover Air Force Base, Delaware

Langley Air Force Base, Virginia

Moody Air Force Base, Georgia

Pope Air Force Base, North Carolina

Seymour Johnson Air Force Base, North Carolina

## Army:

Headquarters, Department of the Army  
Washington, D.C.

Training and Doctrine Command, Fort Monroe  
Hampton, Virginia

XVIII Airborne Corps and Fort Bragg, North Carolina

Fort Belvoir, Virginia

Fort Lee, Virginia

Walter Reed Army Medical Center  
Washington, D.C.

## Navy:

Chief of Naval Operations  
Washington, D.C.

Navy Material Command  
Washington, D.C.

Naval Supply Systems Command  
Washington, D.C.

Commander in Chief  
U.S. Atlantic Fleet  
Norfolk, Virginia

Commander  
Naval Surface Force  
U.S. Atlantic Fleet  
Norfolk, Virginia

Shore Intermediate Maintenance Activity  
Little Creek, Virginia

Shore Intermediate Maintenance Activity  
Norfolk, Virginia

Naval Supply Center  
Norfolk, Virginia



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## ASSISTANT SECRETARY OF DEFENSE

WASHINGTON D C 20301

13 MAR 1981

Mr. D.L. Scantlebury  
Director, Accounting and Financial  
Management Division  
United States General Accounting Office  
Washington, D.C. 20548

Dear Mr. Scantlebury:

This is in reply to your letter of February 10, 1981, to the Secretary of Defense which requested review and comment on your proposed report on the Defense Department's Productivity Enhancing Incentive Fund Program, "Incentive Programs to Improve Productivity Through Capital Investments Can Work," (OSD Case 5635, GAO Job Code 910316).

After reviewing this proposed report, we believe it appropriate to respond to the points indicating GAO's assessment of the adequacy of the Department of Defense oversight and monitorship of this effort and the credibility of the individual component Productivity Enhancing Incentive Fund (PEIF) programs. Responses to each of the report recommendations indicating our specific concerns are provided for your consideration.

The Department of Defense strongly disagrees with GAO's assessment of the Office of the Secretary of Defense (OSD) management of the program. It is our belief that adequate guidance and oversight, relative to the cost of the program, is being provided by OSD through the Defense Productivity Program Office.

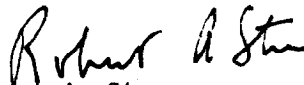
DoD is disappointed by the fact that the report fails to recognize that, over the past two years, DoD has developed and promoted an overall Productivity Enhancing Capital Investment (PECI) strategy that addresses the full spectrum of our need to encourage productivity improvements across all DoD activities. The report also fails to acknowledge the inherent relationship between the management of PEIF and the management of other Peci efforts to promote capital investments in equipment and facilities that improve resource utilization.

DoD agrees that some improvement is needed in service implementation of OSD's guidance and we have worked continually since the program's inception in FY 77, to improve the efficacy and credibility of this program.

The General Accounting Office does recognize DoD's PEIF program as a unique program which can make significant contributions to productivity improvement. The program has been similarly recognized by the Office of Personnel Management and has been selected and documented by their office as an exemplary practice in federal productivity improvement. It is discouraging, therefore, to find that the GAO report recommends discontinuing any program with the stated potential of PEIF unless absolute guarantees could be provided that no chance for any program deficiency exists.

OSD will take every cost effective action possible to improve post investment accountability and ensure the integrity of the individual service PEIF programs. The Departments of Army and Air Force have already initiated actions to improve program management in accordance with the recommendations of the GAO study. The Department of the Navy has also agreed that it will reevaluate its present management oversight of this program and submit a plan of action to correct program deficiencies to OSD for review and approval prior to the expenditure of FY 82 program funds.

Sincerely,



Robert A. Stone  
Acting Assistant Secretary of Defense  
(Manpower, Reserve Affairs & Logistics)

Enclosure:  
Response to Report  
Recommendations

ANALYSIS OF DRAFT OF PROPOSED REPORT BY GAO  
"Incentive Programs to Improve Productivity  
Through Capital Investments Can Work"  
(GAO Code 910316)(OSD Case #5635)

CHAPTER 2

RECOMMENDATION:

(Pg 7) <sup>1/</sup> "that Secretary of Defense direct the Director of the Defense Productivity Program Office to evaluate the relative merits of all capital investment incentive programs for which it has responsibility to determine whether or not resources needed to insure proper program implementation and guidance can be made available to the PEIF program."

(Pg 7) "If it is determined that needed resources cannot be applied to the PEIF program, the SecDef should make Congress aware of OSD's inability to operate the program, and request the program mandate be lifted."

DoD Response. DoD disagrees with the conclusion that OSD has not applied sufficient resources to give guidance to the services and to promote the program. In response to the Congressional guidelines, the interim guidance issued for the PEIF by ASD(MRA&L) in November 1978 were, in GAO's stated opinion, adequate to respond to the desires of the Committee. The PEI program was expanded in 1979 to incorporate recommendations of OMB and to include a full range of productivity enhancing investment programs. At that time it was determined that the interim guidelines were adequate for program continuance and OSD decided that formal guidance for PEIF would be incorporated in a DoD Instruction encompassing the full program. This decision invalidated much of the timetable cited in the initial action plan. However, the accomplishment of most of the actions of that plan were carried out through other DoD issuances; i.e. the DoD budget and program guidance documents. The GAO report also fails to note that the on-site review of service programs mentioned in the action plan is being conducted by the Defense Audit Service.

ASD(MRA&L) and the Director, DPPO, subsequently also issued memoranda to the component heads and their respective productivity principals which emphasize OSD support for the PEIF program, cite the need for information to improve program credibility, and amplify the procedures and requirements contained in the interim instructions. Other actions listed in the initial plan provided to Congress currently remain in suspense due to their contingency upon the issuance of the formal DoD instruction. This instruction was issued on December 31, 1980. The components were given six months to promulgate implementing instructions. Consequently, the remaining step of the plan -- the review of component implementing instructions -- will be performed during the latter part of this coming summer.

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<sup>1/</sup>Page numbers have been changed to correspond to page numbers in final report.



DoD disagrees with the statement that much of the effort of the OSD staff has been devoted to a "new major productivity program". The entire effort in DPPO relates to the improvement of all facets of the DoD program. A major thrust over the past two years has been the development of a comprehensive investment strategy to include the standardization of documentation formats, prioritization of projects for approval, post investment evaluation requirements and audit policies. These actions apply to all PECIs and contribute to the improvement of PEIF program management concomitantly with all other elements of the program.

GAO's assessment of OSD staff resources as "limited" is subjective and without substantiative basis. OSD has allocated resources to oversight of PEIF and all other PEI efforts in direct proportion to their respective costs and expected benefits.

### CHAPTER 3

#### RECOMMENDATION:

(Pg 16 ) "that the Secretaries of the Air Force and Army take action to enhance its credibility by:

- establishing a system of independent, onsite post audits to validate savings achieved, and
- submitting the required reports on where saving have realized and applied as part of the budget program."

DoD response. Agree. Although a continuing formal audit system is not in place in any PEIF program at this time, the Department of Air Force Audit Agency has performed audits of a number of that service's PEIF projects. The results of this audit were included in our March 1980 report to Congress. In addition, the Department of Army has performed on-site reviews of a selected number of PEI projects including some of its PEIF projects. The results of this review will also be provided to Congress. None of this information appears in the GAO report. However, both Air Force and Army indicate that they will comply with the recommendations of the report and include these actions as an inherent part of their programs.

The issuance of DoD Instruction 5010.36, "DoD Productivity Enhancing Capital Investments", formalized the requirements for a system of on-site audits and reports to be carried out in accordance with DoD Instruction 7600.3. Components have until June 30, 1981 to comply and write their implementing regulations for DoD Instruction 5010.36.

CHAPTER 4RECOMMENDATIONS:

(Pg 22) "that the Secretary of the Navy not request additional funding for the PEIF program until an action plan for improving program management is developed and then reviewed and approved by the Secretary of Defense."

(Pg 22 ) "This plan should provide for the

- (1) application of the management resources necessary to promote and support the program at an adequate level and to ensure that only valid and supportable projects are approved,
- (2) revision of Navy guidance for the program to ensure compliance with OSD and congressional requirements, and
- (3) establishment of a system of independent, on-site post audit of selected projects."

DoD response. Agree. The Office of the Secretary of the Navy was apprised of certain program deficiencies in correspondence from OASD(MRA&L) prior to the issuance of GAO's draft report. We have also informed Congress of the lack of followup information on Navy projects and that actions were being taken by Navy to correct this situation. Although Navy has expressed reservations relating to certain of the specific findings stated in the report, it has agreed to submit an action plan to OSD for review and approval before using FY82 program funding to finance PEIF projects. This plan will identify Navy's intentions and the actions it will take and the resources to be applied to improve management of its PEIF program.

(910316)



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U. S. GENERAL ACCOUNTING OFFICE**



**THIRD CLASS**