

GAO

Report to the Chairman, Subcommittee
on Oversight of Government
Management, Committee on
Governmental Affairs, U.S. Senate

February 1991

DEFENSE INVENTORY

Defense Logistics Agency Customers Order Supplies Uneconomically



RELEASED

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**National Security and
International Affairs Division**

B-241013

February 14, 1991

The Honorable Carl Levin
Chairman, Subcommittee on
Oversight of Government Management
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

As you requested, we reviewed how the military services submit requisitions for supplies to the Defense Logistics Agency (DLA) to determine if they are using economical methods. We analyzed the approximately 17 million requisitions that DLA filled from its inventories during fiscal year 1989. Specifically, we determined how often customers placed requisitions that cost DLA more to fill than the value of the supplies provided and how often they requisitioned the same supply item two or more times on the same day. We also analyzed all requisitions filled in fiscal year 1989 by one of DLA's six supply centers to determine how often priority services were requested when it was not necessary.

Results in Brief

Customers added millions of dollars to DLA's supply operations costs because they routinely used uneconomical methods to order supplies. For example, during fiscal year 1989 customers placed about 5.7 million requisitions for supplies valued at \$11 or less, which is the estimated cost to process a requisition. We estimate that DLA spent about \$62.9 million more to fill these low-value requisitions than the \$22.6 million it charged the customer.

In addition, customers—on about 750,000 occasions—submitted two or more requisitions for the same supply item on the same day. Filling these multiple requisitions added nearly \$12.1 million to DLA's operations costs.

On many occasions, customers also requested higher priority service than necessary. In its Total Package Fielding Program, for example, the Army requires its units to use a predetermined high priority on all requisitions for repair parts, regardless of when they are needed. This practice is inconsistent with Department of Defense (DOD) supply policy, which requires a case-by-case determination of priority. This unnecessary use of priority services needlessly increases DLA's costs to fill requisitions.

DOD has directed supply organizations, including DLA, to recover the full cost of its operations from customers beginning October 1, 1990. DOD has proposed that the supply organizations add a surcharge to each requisition based on a percentage of the value of the item requested. While we agree that full costs should be recovered, this type of surcharge, by itself, will not provide customers with an incentive to consolidate their requisitions because they will pay the same surcharge for each item, regardless of the number of requisitions submitted. Also, because its primary emphasis is fulfillment of customer requisitions, DLA will have little incentive to change the methods that customers use to requisition supplies. Establishing a minimum charge per requisition would not only allow DLA to recover its full costs but also should encourage customers to submit fewer low-value requisitions, to eliminate multiple requisitions for the same item on the same day, and to request priority service only when needed.

Background

The Secretary of Defense created DLA in 1962 to be the wholesale manager of consumable supplies commonly used by the military services, other DOD components, and federal agencies. As a wholesaler, DLA is to procure, stock, and issue supply items generally in economic quantities to its customers. During fiscal year 1989, DLA stocked 2 million items, of which 49 percent had a unit price of \$10 or less. During that year, DLA's operating costs were nearly \$670 million (excluding fuels and subsistence items) to process and fill about 17 million customer requisitions for items valued at about \$4 billion. These items included weapons parts as well as common items such as nuts, washers, screws, electrical fuses, batteries, and shampoo.

Although DLA provides the supplies, the customer determines the quantities required and the number of requisitions submitted. The customer also assigns a priority to indicate the urgency of its need. Upon receipt of the customer's requisition, the DLA supply center having accountability for the item processes the requisition and directs a storage depot to issue the material to the customer. The timeliness of the service provided depends on the priority that the customer assigns to the requisition.

DLA charges its customers for the cost of the supplies requisitioned, plus a surcharge to cover expenses, such as inventory spoilage and waste, inventory maintenance, transportation, and inflation. Supply item prices do not include charges to cover DLA's costs to process requisitions

because these costs have traditionally been covered by DLA's appropriated funds. Also, these prices do not include charges to cover faster service that DLA provides on higher priority requisitions. In 1989, DOD recognized that to make supply operations more efficient and effective, managers must have additional information on their costs and the incentive to better manage the way they do business. DOD recently initiated actions to run its supply operations in a more businesslike manner by requiring supply activities to recover all their costs from customers beginning October 1, 1990.

Customers Use Uneconomical Methods to Order Supplies

Although customers traditionally have not paid the costs of processing and filling requisitions, DOD requires¹ them to use ordering methods that minimize DLA's operating expenses. We found, however, that customers routinely used methods to requisition supplies that unnecessarily increased DLA's costs. Specifically, customers placed numerous low-value requisitions that cost DLA more to fill than the value of the supplies provided, submitted two or more requisitions for the same supply items on the same day, and requested higher priority service than needed.

DLA Fills Numerous Low-Value Requisitions

Our analysis of about 17 million supply requisitions that DLA filled from its inventories during fiscal year 1989 identified about 5.7 million that had a total value of \$11 or less, which is the estimated cost to process a requisition. Table 1 shows the ranges of the value of supplies ordered per requisition filled during fiscal year 1989.

Table 1: Value Ranges of Requisitions DLA Filled During Fiscal Year 1989

Value ranges	Number of requisitions	Cumulative percent
\$ 0.01-1.00	1,270,354	7
1.01-5.00	2,505,721	22
5.01-11.00	1,940,572	34
11.01-20.00	1,730,688	44
20.01-30.00	1,227,611	51
30.01-100.00	3,590,811	72
Over 100.00	4,744,873	100
Total	17,010,630	

¹DLA Manual 5105.1, Department of Defense Supply Management Reference Book, Jan. 1985.

Of the about 1.3 million requisitions for supplies with a value of \$0.01 to \$1.00, about 515,000 were for only one item. The following are examples of some of these requisitions, all of which were high priority.

- A Foreign Military Sales customer in the Middle East requisitioned one AAA-size battery valued at \$0.13.
- An Air Force contractor in Colorado requisitioned one AA-size battery valued at \$0.10.
- An Air Force hospital in New Mexico ordered a 4-ounce bottle of medicated shampoo valued at \$0.66.
- An Army maintenance activity in Germany requisitioned one 2.5-inch nylon strap valued at \$0.01.
- A Navy ship requisitioned one steel lock washer valued at \$0.01.

DLA fills low-value requisitions because it views itself as a service organization whose mission is to provide what its customers order, whether or not it is economical to do so. Moreover, DLA has an incentive to fill such requisitions because its primary emphasis is supply availability—how often it can fill requisitions. Therefore, the smaller the quantity requisitioned, the greater the likelihood that DLA can fill it.

Because DLA had not determined its average cost to fill a requisition, we analyzed supply center and depot operation costs to develop a reasonable estimate. We found that during fiscal year 1989, it cost DLA about \$11 to fill (pick, pack, and prepare inventory items for shipping) requisitions for small supply items, such as nuts, washers, screws, batteries, electrical fuses, and shampoo. Larger supply items and bulk shipments cost more. DLA supply officials reviewed our cost analysis and agreed that \$11 was a reasonable estimate.

At an estimated processing cost of \$11 per requisition, DLA spent about \$62.9 million more than the \$22.6 million DLA charged its customers to fill about 5.7 million requisitions for supplies valued at \$11 and less.

DOD directed that beginning October 1, 1990, all supply agencies, including DLA, levy a surcharge on each requisition to recover the full cost of its supply operations. To implement this direction, DLA has determined surcharges by commodity,² ranging from 19.3 percent for medical supplies to 48.8 percent for industrial items. The surcharges are

²DLA's proposed surcharge rates for fiscal year 1991 by commodity are 19.3 percent-medical; 20.8 percent-clothing and textiles; 31.2 percent-general; 40.1 percent-construction; 44.2 percent-electronics; and 48.8 percent-industrial.

intended to make supply agencies and their customers more conscious of total supply costs and to encourage them to make more efficient supply decisions.

Military customers told us that the surcharges proposed by DLA provide no incentive to reduce the number of low-value requisitions. Because the surcharge is a percentage of the value of the item requisitioned, DLA will charge customers the same amount, regardless of the number of requisitions they submit for the item. For example, a customer placing 100 requisitions, each for the same \$1 electronic supply item, would pay a 44.2 percent surcharge on each requisition, for a total of \$44.20. However, a customer placing only one requisition for 100 of the same item would also pay a 44.2 percent surcharge, or \$44.20.

In lieu of the proposed surcharge when it is not sufficient to recover processing costs, DLA could charge a minimum fee for each requisition the customer submits. This fee, if set at the proper amount, would not only allow DLA to recover its cost to process a requisition, but also would provide customers with an incentive to reduce the number of requisitions. For example, if DLA were to charge a minimum fee similar to the \$11 mentioned above, customers would likely consolidate their requisitions, particularly for low-value items, thereby reducing DLA's overall operating costs. The charge of a minimum fee per requisition could encourage customers to purchase some low-value supplies, such as nuts and screws, from local commercial sources. While we have not assessed the impact of this potential change, a January 1986 DOD study³ concluded that when the cost of supplying an item to the customer is greater than its value, logistics support may be improved and dollars saved if customers purchase supply needs locally.

Multiple Requisitions Increase Supply Operations Costs

Our analysis identified about 755,000 instances (involving about 1.8 million requisitions) where the same customer requisitioned the same item more than once on the same day. Charging a minimum fee per requisition could also help reduce the number of multiple requisitions placed for the same item on the same day. Table 2 shows the number of instances where customers placed multiple requisitions for the same item on the same day.

³Uniform Materiel Movement and Issue Priority System Improvement Study, DOD Logistics Analysis Office (Falls Church, Va.; Jan. 1986).

Table 2: Multiple Requisitions on the Same Day During Fiscal Year 1989 for the Same Item

Number of requisitions on a day	Total number of instances	Percent of total
2	589,065	78.0
3	96,373	12.8
4	35,219	4.7
5	14,453	1.9
6	6,786	0.9
7	3,578	0.5
8	2,404	0.3
9	1,792	0.2
10 and over	5,126	0.7
Total	754,796	100.0

We estimated that if these customers had placed a single requisition to meet their supply requirements, DLA's operations costs would have been decreased by nearly \$12.1 million in fiscal year 1989. The following are examples involving large numbers of multiple requisitions and their potential impact on DLA's operations costs.

- The U.S. Army Tank Automotive Command, Warren, Michigan, placed 76 supply requisitions for a 15-amp. fuse cartridge costing \$0.10 each on January 24, 1989. Of these requisitions, 74 requested 5 fuses each and 2 requested 10 fuses. At an estimated processing cost of \$11 per requisition, DLA spent \$836 to provide the Army with \$39 worth of fuses. If the customer had placed one requisition on January 24, 1989, for 390 fuses, DLA's estimated processing cost would have been reduced by \$825, or 99 percent.
- The U.S. Marine Corps Blount Island Command, Jacksonville, Florida, placed 36, 26, and 20 requisitions for an 8-ounce oil can priced at \$1.27 on August 11, 14, and 15, 1989, respectively. All 82 of these requisitions were for one can. At an estimated processing cost of \$11 for each requisition, DLA spent \$902 to provide the 82 cans. If the customer had submitted only one requisition each day, DLA's estimated processing cost would have been reduced by \$869, or 96 percent.
- The Naval Aviation Depot in Pensacola, Florida, submitted 23, 63, and 19 requisitions for cam collars priced at \$3.34 each on 3 consecutive days in October 1988. Eighty-two of these 105 requisitions were for 12 items each. At an estimated processing cost of \$11 per requisition, DLA spent \$1,155 to fill the 105 requisitions. If the customer had submitted one requisition each day to obtain the supply items, DLA's estimated processing cost would have been reduced by \$1,122, or 97 percent.

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- The Air Force Aerospace Guidance and Metrology Center, Newark Air Force Base, Ohio, placed 20 requisitions for a \$2.73 transistor on July 17, 1989. Of these 20 requisitions, 15 requested 1 item each, 4 requested 2 items each, and 1 requested 20 items. At an estimated processing cost of \$11 per requisition, it cost DLA \$220 to fill these 20 requisitions. If the customer had placed one requisition for 43 transistors on July 17, 1989, DLA's estimated processing cost would have been reduced by \$209, or 95 percent.

We interviewed DLA customers at 11 locations to determine why they placed multiple requisitions for individual stock items. Generally, these customers stated that multiple requisitions allowed them better control and accountability over normal supply operations or special projects. For example, officials at the Marine Corps Blount Island Command, which submitted 82 requisitions for one 8-ounce oil can each, said they had submitted multiple requisitions so they could track them to 82 specific vehicles.

Customers Request Higher Priority Service Than Needed

A DOD directive⁴ requires that customers assign a priority to each requisition to indicate how urgently they need the supplies. The assigned priority establishes the maximum time allowed for each step of the requisition process—beginning with submission of the requisition and ending with the receipt of supplies. For example, for a high priority requisition, 1 day is allowed between the time a customer prepares and submits it and DLA receives it. Once DLA receives the requisition, it has a maximum of 17 days to route the requisition to the supply depot that stocks the requested supply item, retrieve the proper number of items from stock, and package and ship the items to a customer located anywhere in the continental United States. According to DOD, the first and most important step of the supply process is the period from the date the customer prepares and submits the requisition to the date the requisition is received by DLA. Delay in this step can prevent DLA from meeting the customer's required delivery date.

In its January 1986 report on DOD's Uniform Materiel Movement and Issue Priority System, the DOD Logistics Systems Analysis Office showed that, based on a sample of the more than 3.3 million requisitions filled during June 1985, DLA customers requested priority service on 41 percent of their requisitions. However, only 40 percent of these met the DOD submission time standard of 1 day. The Office concluded that customers

⁴DOD Directive 4410.6, Uniform Materiel Movement and Issue Priority System, Oct. 1980.

who exceeded the time standard may not have actually needed priority service. To help prevent continued abuse of the priority system, the Office recommended that customers be charged a uniform fee for priority service. DOD did not implement this recommendation.

We analyzed about 3 million customer requisitions filed by DLA's Defense Electronics Supply Center, Dayton, Ohio, during fiscal year 1989, which was the only center where submission time data was readily available. We found that customers requested priority service on about 43 percent (1.3 million) of the 3 million requisitions. However, only 39 percent (about 0.5 million) of these priority requisitions met the DOD 1-day submission time standard. Table 3 shows the number of days between the date customers prepared the nearly 1.3 million high priority requisitions and the date the Defense Electronics Supply Center received them.

Table 3: Submission Times of High Priority Requisitions Processed by the Defense Electronics Supply Center During Fiscal Year 1989

Submission time (in days)	Number of requisitions	Percent of high priority requisitions
1 or less	501,842	38.8
2 to 11	564,037	43.7
12 to 18	77,116	6.0
19 to 38	74,613	5.8
39 to 98	48,026	3.7
99 and over	26,138	2.0
Total	1,291,772	100.0

Customers failed to meet the DOD requisition submission time standard on about 790,000, or 61 percent, of their high priority requisitions. Of these, about 149,000 requisitions took more than 18 days to be received by the supply center—18 days is the maximum time allowed under the DOD time standards for the entire process for customers located in the continental United States.

Army Program Is Inconsistent With DOD Supply Policy

The Armywide Total Package Fielding Program is inconsistent with DOD's policy that requires supply customers to request high priority service based on how urgently the supplies are needed. Under this program, when the Army provides its units with new weapons and equipment such as tanks, bulldozers, cranes, and radios, it also provides initial repair parts at the same time, as a total package. In implementing

the program in 1988, the Army mandated⁵ that all requisitions for initial repair parts request high priority service—urgency of need was not a consideration. For example, under this program, the Army's Tank Automotive Command and the Communications and Electronics Command submitted high priority requisitions for four types of electronics items that were delivered to the New Cumberland Army Depot, New Cumberland, Pennsylvania. After receiving these items, however, the Depot held them for as long as 363 days before the Commands told them to assemble and ship the packages to the users. Table 4 shows the minimum and maximum storage time of these four supply items at the New Cumberland Army Depot.

Table 4: Storage Time for Selected Requisition Items

Item	Number of requisitions	Number of days stored	
		minimum	maximum
Antenna adapter assembly	91	28	192
15-amp. fuse cartridge	107	65	363
5-amp. fuse cartridge	34	93	272
Light-emitting diode	60	35	321

According to DOD supply policy guidance, this type of predetermined assignment of priorities can result in the misuse of the priority system and can unnecessarily increase supply operating costs.

Recommendations

To provide the military services and other supply system customers with incentives to use more economical ordering methods and high priority services only when necessary, we recommend that the Secretary of Defense direct the Director, DLA, to

- determine the cost of filling a requisition and levy a minimum charge per requisition when the percentage surcharge based on the value of the item is not sufficient to recover this cost and
- determine the additional cost for processing high priority requisitions and charge customers for this service.

We also recommend that the Secretary of Defense direct the Secretary of the Army to discontinue the policy of assigning a predetermined high priority to all requisitions submitted under the Total Package Fielding Program.

⁵Army Pamphlet 700-142, Instructions for Materiel Release, Fielding, and Transfer, May 1988.

Agency Comments

DOD agreed that its requisition practices should be modified to minimize costs, but did not fully accept our recommended solutions. The Department agreed to discontinue the Army's policy of using a high priority designation for all requisitions submitted under the Total Package Fielding Program. However, before imposing minimum fees to reduce submission of low-value requisitions and priority service fees to limit unnecessary use of the priority system, DOD requested time to identify and evaluate alternative solutions.

DOD believes our recommendations would penalize some supply system customers. Our recommendations were not intended to penalize, but to ensure that those units and organizations which use multiple and high priority requisitions pay for that use. Our recommendations allow a unit to decide if requisitioning items separately in order to maintain control, for example, is worth the additional costs incurred to the unit. Similarly, charging a fee for priority ordering would allow a unit to decide if the order was worth incurring the additional cost.

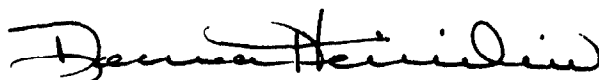
DOD said that it plans to designate an executive agent during the first quarter of calendar year 1991 to develop specific solutions to the problems which cause customers to generate numerous low-value requisitions. DOD did not indicate what these solutions might be. DOD also said that it had implemented a recent policy change to reduce the principal costs associated with high priority requisitions. DOD said that it planned to conduct an internal review of the effectiveness of that policy change not later than July 1991, and if the review shows that the policy change has been ineffective, then additional measures will be taken.

We have no objection to DOD's proposal to develop, implement, and test alternative solutions to its requisition processing problems. However, if by March 1992 (approximately 1 year after implementation) these alternatives have not been proven effective, the Secretary of Defense should direct the Director, DLA, to immediately implement our recommendations. We intend to follow up on DOD's actions.

Unless you announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies of this report to the Secretaries of Defense, Army, Navy, and Air Force and the Directors of DLA and the Office of Management and Budget. We will make copies available to others on request.

Appendix I describes our scope and methodology. Appendix II contains agency comments on a draft of this report. The major contributors to this report are listed in appendix III. Please contact me on (202) 275-8412 if you or your staff have any questions concerning this report.

Sincerely yours,



Donna M. Heivilin
Director, Logistics Issues

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Abbreviations

DLA	Defense Logistics Agency
DOD	Department of Defense

Scope and Methodology

We conducted our work primarily at the Defense Logistics Agency (DLA) headquarters in Cameron Station, Virginia, and two of its six supply centers—the Defense Electronics Supply Center, Dayton, Ohio, and the Defense Personnel Support Center, Philadelphia, Pennsylvania. Information was also obtained from the Defense Construction Supply Center, Columbus, Ohio; the Defense General Supply Center, Richmond, Virginia; the Defense Industrial Supply Center, Philadelphia, Pennsylvania; and the Defense Depot in Mechanicsburg, Pennsylvania. Although DOD's wholesale supply management system includes the Army, Navy, Marine Corps, Air Force, and DLA, we limited our review to customers who requisitioned supplies from DLA.

To determine customer views on the use of DLA's supply system, we interviewed users at the Aerospace Guidance and Metrology Center, Newark Air Force Base, Ohio; Oklahoma City Air Logistics Center, Tinker Air Force Base, Oklahoma; Oklahoma Air National Guard, Oklahoma City, Oklahoma; Air Force Communications Command, Tinker Air Force Base, Oklahoma; New Cumberland Army Depot, New Cumberland, Pennsylvania; U.S. Army Support Activity, Philadelphia, Pennsylvania; U.S. Army Tank Automotive Command, Warren, Michigan; U.S. Army Communications and Electronics Command, Ft. Monmouth, New Jersey; Naval Aviation Depot, Pensacola, Florida; Naval Aviation Depot, Jacksonville, Florida; and U.S. Marine Corps Blount Island Command, Jacksonville, Florida.

We reviewed pertinent documents and interviewed DLA officials to identify controls and procedures guiding the DLA supply process. To identify the customer supply requisitions that DLA filled during fiscal year 1989, we obtained data from the Defense Automatic Addressing System Office's closed requisition history file. Although we sought explanations for apparent data anomalies, we did not independently verify the full computer-generated data base, which includes information on about 17 million requisitions.

To determine whether DLA's customers used economical methods to order supplies, we compared the total value of the requisitions submitted to the cost to process the requisition. The total values were calculated by multiplying the unit price by the quantity requisitioned. We stratified their values into seven ranges; for example, \$1.01 - \$5.00 is one value range.

We used data provided by DLA to estimate the cost of filling customer requisitions. We based our average cost estimate on DLA's cost estimates

for supply center requisition processing and depot operations to pick, pack, and ship small supply items. Our cost estimate does not include the costs to DLA for either purchasing, receiving, and stocking supply items or for picking, packing, and shipping large supply items that require the use of heavy equipment. We did not independently verify DLA's cost data, but we did obtain DLA comptroller officials' views on the reasonableness at that date.

We identified customers who ordered the same item more than once on the same day. From this list of customers, we selected and traced a limited sample to identify their reasons for submitting multiple requisitions. Our selection was primarily made from those customers who placed the largest number of multiple requisitions.

To determine whether DLA customers used supply requisition priorities appropriately, we compared the priority used by customers and the time they took to submit supply requests to the Defense Electronics Supply Center. We identified the number of customers that delayed submitting their request longer than the time standard for processing it. Additionally, we asked selected customers why they had placed supply requests at higher priorities than they needed for normal replenishment. Because of its small size, we were not able to project the results of our customer sample.

We conducted our work from September 1989 through August 1990 in accordance with generally accepted government auditing standards.

Comments From The Department of Defense



PRODUCTION AND LOGISTICS

(L/SD)

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, DC 20301-8000

December 31, 1990

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Conahan:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report, "DEFENSE INVENTORY: Defense Logistics Agency Customers Order Supplies Uneconomically," dated October 10, 1990 (GAO Code 398013/OSD Case 8500).

The Department agrees that requisitioning practices should be modified to minimize costs. However, the GAO does not identify the optimal method of controlling the costs of processing requisitions. The GAO advocates imposing a minimum fee per requisition and a financial penalty for submitting a high priority requisition; the Department supports an alternative approach.

The DoD plans to designate an executive agent to make recommendations as to how to reduce the quantity of low-value requisitions being generated by customers of the supply system. Recent changes to DoD policy require a requisitioning activity to identify its transportation priority separately from its priority for the materiel allocation of assets. Because premium transportation is the primary reason that high priority requisitions are not economical, the Department should be afforded an opportunity to see if the new policy reduces costs before additional measures are considered.

The detailed DoD comments on the report findings and recommendations are provided in the enclosure. The Department appreciates the opportunity to comment on the draft report.

Sincerely,

David J. Berteau
Principal Deputy

Enclosure

GAO DRAFT REPORT - DATED OCTOBER 10, 1990
(GAO CODE 398013) OSD CASE 8500

"DEFENSE INVENTORY: DEFENSE LOGISTICS AGENCY CUSTOMERS
ORDER SUPPLIES UNECONOMICALLY"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

FINDINGS

FINDING A: Role Of The Defense Logistics Agency As A Wholesale Manager. The GAO reported that the Defense Logistics Agency was established to be the wholesale manager of consumable supplies commonly used by the Services, other DoD components, and Federal agencies. The GAO explained that, as a wholesaler, the Defense Logistics Agency (Agency) is to procure, stock, and issue supply items generally in economic quantities for its customers. The GAO noted that during FY 1989, the Agency stocked about two million items--of which 49 percent had a unit price of \$10 or less. The GAO also explained that, while the Agency provides the supplies, the customer determines the quantities required and the number of requisitions submitted, and also assigns the priority to indicate the urgency of the need.

The GAO reported that the Defense Logistics Agency charges its customers for the cost of the supplies requisitioned, plus a surcharge to cover various expenses. The GAO noted, however, that the supply item prices do not include charges to cover some Agency costs, such as requisition processing costs or charges to cover faster service on high priority requisitions. The GAO found that, in 1989, the DoD recognized that, to make supply operations more efficient and effective, managers must have additional information on their costs and the incentive to better manage the way they do business. The GAO also found that, beginning October 1, 1990, the DoD initiated actions to run its supply operations in a more businesslike manner by requiring supply activities to recover all their costs from customers. (pp. 3-5/GAO Draft Report)

DoD Response: Concur

Now on pp. 2 and 3.

FINDING B: The Defense Logistics Agency Fills Numerous Low-Value Requisitions. The GAO found that, of about 17 million supply requisitions the Defense Logistics Agency filled in FY 1989, about 5.7 million had a total value of \$11 or less--which is the estimated cost to process a requisition. The GAO discussed several examples of such low-value requisitions, all of which had been designated a high priority. According to the GAO, the Agency fills such low-value requisitions because it views itself as a service organization, whose mission is to provide what the customers order--whether or not it is economical. In addition, the GAO reported that the Agency has an incentive to fill the low-value requisitions, because its primary emphasis has been and is supply availability.

Based on an estimated processing cost of \$11 per requisition, the GAO found that the Defense Logistics Agency spent about \$62.9 million more than the \$22.6 million the Agency charged its customers to fill about 5.7 million requisitions for supplies valued at \$11 or less. In that regard, the GAO found that, beginning October 1, 1990, the DoD directed all supply agencies to levy a surcharge on each requisition to recover the full cost of the supply operations. To accomplish that objective, the GAO found that the Agency identified surcharges by commodity--which are intended to make supply customers more conscious of total supply costs and encourage more efficient decisions.

The GAO reported, however, that Military customers said the Defense Logistics Agency surcharges provide no incentive to reduce the number of low-value requisitions. The GAO explained that, because the surcharge is a percentage of the value of the item requisitioned, the Agency charges customers the same amount, regardless of the number of requisitions submitted. The GAO concluded that instead, the Agency could charge a minimum fee for each requisition submitted--which, if set at the proper amount, would not only allow the Defense Logistics Agency to recover its requisition processing cost, but also provide customers with an incentive to reduce the number of requisitions. The GAO further concluded that a minimum fee per requisition could encourage customers to purchase some low-value supplies from local commercial sources. (pp. 2-3, pp. 5-10/GAO Draft Report)

DoD Response: Concur. The DoD notes, however, the GAO estimate that the Defense Logistics Agency spent about \$62.9 million more than it charged its customers to fill about 5.7 million requisitions may be too high. The GAO assumed a processing cost of \$11 per requisition.

Now on pp. 1-5.

However, many of the items had identical stock numbers and were retrieved from storage, packed, and shipped at the same time, resulting in a processing cost of less than \$11 each. Nevertheless, the DoD has long recognized that small quantities of low dollar value requisitions are expensive to process. That cost has been built into economic order quantity computations.

Although 34 percent of the requisitions monitored were \$11 and under, 66 percent were over \$11, and 48 percent of those were over \$20. The recoupment of costs through the surcharge on high-value, large-quantity requisitions offsets losses on the low-value, low-quantity requisitions. Prior to FY 1991, stock fund pricing was structured to cover the acquisition cost of an item, plus the cost of transportation and related surcharges. As such, the surcharges for stock funds are designed so that, on balance, the stock fund manager (in this case, the Defense Logistics Agency) will break even, not make a profit.

Effective in FY 1991, stock fund pricing will also include the costs of supply operations. Those costs were previously financed through the operation and maintenance appropriations. The resulting increase in surcharge rates is expected to provide customers with an incentive to avoid unnecessary requisitioning and to give due consideration to the use of local purchase procedures where feasible.

FINDING C: Impact Of Multiple Requisitions. The GAO analyzed approximately 17 million requisitions that the Defense Logistics Agency filled from its inventories during FY 1989--and identified about 755,000 instances (involving about 1.8 million requisitions) where the same customer requisitioned the same item more than once on the same day. The GAO discussed several examples of such multiple requisitions and estimated that, if those customers had placed a single requisition to meet their supply requirements, in FY 1989, the Agency operations costs would have been decreased by nearly \$12.1 million. According to the GAO, the customers generally said that multiple requisitions allowed them better control and accountability over normal supply operations or special projects. The GAO concluded, however, that such multiple requisitions increase supply operations costs. The GAO further concluded that charging a minimum fee per requisition could also help reduce the number of multiple requisitions placed for the same item on the same day. (p. 2, pp. 10-13/GAO Draft Report)

Now on pp. 1 and 2, 5-7.

DoD Response: Partially concur. The DoD cannot verify that placing a single requisition to satisfy the requirements of customers ordering the same item more than once on the same day would have decreased the Defense Logistics Agency operating costs by nearly \$12.1 million. In addition, the total costs to the DoD should also be considered. Consolidation of the requirements at the depots prior to shipment already reduces operating costs. On the other hand, the customer also incurs additional costs to batch process requisitions, break out the consolidated shipment, and distribute the items contained therein to the appropriate using activities.

It should also be recognized that there may be legitimate reasons for an activity to submit more than one requisition for the same item on the same day. For example, if an activity has two requirements for the same item, but the requirements have sufficiently different priorities such that only one of them falls into the high priority category, governing regulations require the submission of separate requisitions.

FINDING D: Customers Request Higher Priority Service Than Needed.

The GAO reported that DoD Directive 4410.6, Uniform Materiel Movement and Issue Priority System (October 1990), requires customers to assign a priority to each requisition to indicate how urgently the supplies are needed. The GAO explained that the assigned priority establishes the maximum time allowed for each step of the requisition process. The GAO cited a 1986 DoD report indicating that, for requisitions filled during June 1985, customers requested priority service on 41 percent of all their requisitions, but only about 40 percent of those so designated actually met the DoD standard for submission in one day. The GAO pointed out the 1986 DoD report concluded that those customers, who exceed the time standard, may not actually need the priority service--and recommended that customers be charged a uniform fee for priority service. The GAO noted, however, that the DoD did not implement that recommendation.

The GAO analyzed customer requisitions filled by the Defense Electronics Supply Center during FY 1989, and found that customers requested priority service about 43 percent of the time. The GAO further found, however, that only 39 percent of the priority requisitions met the DoD one day standard. The GAO further found that, of about 790,000 of the high priority requisitions, about 149,000 took more than 18 days to be received by the Supply Center--which is the maximum time allowed under DoD time standards for the entire process for customers located in the continental U.S.

Now on pp. 1 and 2, 7 and 8.

The GAO concluded that customers are requesting higher priority service than they need. The GAO also concluded that the unnecessary use of priority services needlessly increases the Defense Logistics Agency costs to fill requisitions. (p. 2, pp. 14-16/GAO Draft Report)

DoD Response: Partially concur. The DoD concurs that customers are requesting high priority service more often than necessary. However, the GAO also found that 61 percent of the high priority requisitions were delayed by the customers themselves for a period of time that exceeded established requisition submission standards. The implication is that, if the customers had overcome whatever problems were responsible for the tardy submission of the requisitions to the wholesale item manager, high priorities would not have been necessary.

There are many reasons that account for delay in requisitions reaching a wholesale inventory manager. Among them are funding constraints, searches for sources of lateral redistribution of existing stock, and geographical location (i.e., overseas customers). Furthermore, batch processing in the various levels of the retail supply system causes built-in delays. Such delays, however, do not negate the underlying urgency of need. In short, the activity-level customer may well have a bona fide requirement for expeditious processing of an order, but procedures have been established to ensure that purchases are not made for items that could be satisfied from existing inventories and that obligations are not incurred prior to the availability of appropriations. In addition, requisitions that are consolidated at the retail level can delay the submission of a requisition to the wholesale item manager. The resulting delays are, therefore, beyond the control of the activity-level customer.

New procedures were promulgated by the Principal Deputy Assistant Secretary of Defense (Production and Logistics) in a memorandum dated March 30, 1990, Subject: "Uniform Materiel Movement and Issue Priority System (UMMIPS) Processing." Those new procedures are the result of the recognition of the fact that the cost of premium transportation associated with high priority requisitions is frequently avoidable. Consequently, the new procedures require the requisitioning activity to indicate on the requisition itself whether premium transportation is required. Failure to do so will result in automatic downgrading of the transportation priority to "routine." Hence the new procedure precludes the unnecessary expenditure of transportation funds for high priority requisitions,

while permitting the supply system to allocate materiel assets on a priority basis.

FINDING E: Comparison Of The Army Program With DoD Supply Policy.

The GAO found that, under the Army-wide Total Package Fielding Program, when the Army provides its units with new weapons and equipment, it also provides initial repair parts at the same time. The GAO also found that, in complementing the program in 1988, the Army mandated that all requisitions for initial repair parts request high priority service--urgency of need was not a consideration. As an example, the GAO reported that, under the program, two Army commands submitted high priority requisitions for four types of electronics items delivered to the New Cumberland Army Depot. The GAO found, however, that after the items were received, the Depot held them for as long as 363 days before the commands told them to assemble and ship the packages. The GAO concluded that the cited Army practice is inconsistent with DoD supply policy that requires a case-by-case determination of priority. The GAO noted that, according to DoD supply guidance, such predetermined assignment of priorities can result in the misuse of the priority system and can unnecessarily increase supply operating costs. (p. 2, pp. 17-18/GAO Draft Report)

Now on pp. 1 and 2, 8 and 9.

DoD Response: Concur. The Army Total Packaging Fielding program is designed to provide receiving activities and their supporting units with everything they need (i.e., end items, tools, test equipment, spare parts, technical manuals, and new equipment training). The fielding schedules are dependent on availability of the units, fielding teams, military schools, and instructors, as well as the availability of the equipment. The equipment packages must be complete before fielding can start. In the first quarter of FY 1988, the Army limited its initial support packages to items needed to satisfy legal, safety, or critical requirements. That greatly reduced the number of lines being fielded.

The Vice Chief of Staff of the Army approved the use of Priority 05 for all Total Packaging Fielding Program requisitions. That was done to ensure that Total Packaging Fielding could access the protected stock levels of weapons systems just entering the inventory. The fill rate for packages is negotiated between each fielding and gaining command, but it usually must be at least 85 percent overall, with a 100 percent fill rate for mission essential items.

Prior to transfer of the packages, the fielding command provides the gaining command with an impact statement for every item (including Defense Logistics Agency items) that is missing from the package. Time is required to accumulate this data after the packages are assembled at the Unit Materiel Fielding Points.

Requisitions for a typical package are generated 100 days prior to the date the package will be shipped from the Unit Materiel Fielding Point. Items will be received for incorporation into the package over an average span of 90 days. Since many fieldings are earmarked for overseas units, the use of Priority 05 is necessary to get them through the transportation system in time. Use of a lower priority would extend the time needed to assemble the packages and ship the equipment. Additionally, it would not permit penetration of protected stock levels of items (including Defense Logistics Agency-managed items) that are in short supply.

The cases cited by the GAO (in which packages remained at the Unit Materiel Fielding Point for 363 days) are the exception rather than the rule. There are many possible reasons for such a delay. Assembly of initial packages begins relatively early in the final stage of fielding and continues during the final stages of acceptance of the weapon system. Therefore, time in which the package remains at the Unit Materiel Fielding Point may be extended by virtue of the fact that the end item may have failed final acceptance testing or because full or conditional release approval for the system was delayed or denied. Critical repair parts may be on backorder and the gaining command would not accept the system without them. Some of the associated items of equipment, such as trucks or generators, might not be available when scheduled. It is also possible that the system was preempted for overseas transportation, the fielding missed the scheduled handoff date, or the next time that the gaining unit can accept the equipment is 6, 9, or even 12 months later. Distribution plans can also change drastically as a result of force structure reductions.

* * * * *

RECOMMENDATIONS

RECOMMENDATION 1: To provide the Military Services and other supply system customers with incentives to use more economical ordering

Now on p. 9.

methods and high priority services only when necessary, the GAO recommended that the Secretary of Defense direct the Director, Defense Logistics Agency, to determine the cost of filling a requisition and levy a minimum charge per requisition, when the percentage surcharge, based on the value of the item, is not sufficient to recover this cost. (pp. 18-19/GAO Draft Report)

DoD Response: Partially concur. The DoD concurs that an effective means must be devised to minimize costs in the requisitioning process. When customers submit multiple requisitions for the same item at the same time to maintain detailed accountability records, track costs to job orders, etc., unnecessary workload is generated for other activities.

However, the experience of the Department has been that wholesale changes to policy and procedures can be counterproductive, because implementation of the changes may result in other costs. In this case, it is foreseeable that there would be unnecessary ordering to reach minimum price thresholds, maintenance of a two-tiered pricing scheme for all products, and increased use of off-line local purchase procedures which normally would cost more than \$11 per transaction to accomplish.

Accordingly, during the first quarter of 1991, the DoD will designate an executive agent for the development of specific solutions to the problems which cause the customers to generate numerous low-value requisitions. The executive agent will be given 90 days to develop a set of recommendations, and once those recommendations are approved by the Office of the Assistant Secretary of Defense (Production and Logistics), they will be implemented. After the recommended changes have been in effect for a reasonable period of time, the Office of the Assistant Secretary of Defense (Production and Logistics) will evaluate the effectiveness of those changes and take additional corrective action if it is warranted.

RECOMMENDATION 2: As another means to provide the Military Services and other supply system customers with incentives to use more economical ordering methods and high priority services only when necessary, the GAO recommended that the Secretary of Defense direct the Director, Defense Logistics Agency, to determine the additional cost for processing high priority requisitions and charge customers for this service. (pp. 18-19/GAO Draft Report)

Now on p. 9.

DoD Response: Partially concur. Most requisitions are passed to the wholesale system because the retail supply system could not satisfy the customer requirements in a timely manner. This is not the fault of the customer. Similarly, when the need for premium transportation is the result of stock positioning, the customer could not control the situation resulting in the requirement that premium transportation costs must be incurred. With the implementation of Defense Management Report Decision 915, and the Assistant Secretary of Defense (Production and Logistics) memorandum, dated March 30, 1990, subject: "Uniform Materiel Movement and Issue Priority System (UMMIPS) Processing," actions have been taken to ensure that a customer's materiel allocation priorities are now identified separately from the transportation priorities on requisitions.

Transportation is the principal cost driver on high priority requisitions. As a result of the policy change described above, customers now have the ability to control transportation costs by assigning a high priority to allocation of materiel assets (so that protectable levels can be penetrated to fill the requisition), while indicating separately whether or not premium transportation is required. This change is expected to save transportation costs, and the DoD needs an opportunity to measure its effectiveness before adopting a more radical solution to the problem of controlling costs associated with abuses of the priority system.

A literal implementation of the GAO recommendation would make the customer liable for the financial consequences of all transportation decisions. This would be inappropriate, because decisions to use premium transportation can be made in spite of the fact that the customer's requisition indicated that routine transportation was acceptable. Such cost increases would ultimately be reflected in customer operation and maintenance budget requests. Additionally, because billing amounts would differ depending on the priority of the requisition, automated data processing programs would have to be modified and maintained to accommodate the requirement.

The DoD Components have long been aware of the tendency to use high priorities on requisitions and they have established several programs to monitor the situation. Component Inspector General and Logistics Review Teams ensure that this item is reviewed during inspections. Mechanisms already exist to identify and rectify priority abuse.

Appendix II
Comments From The Department of Defense

In order to ensure that the customers of the supply system limit requests for high priority services to situations which actually warrant the use of such priorities, the Office of the Secretary of Defense will direct the Components to enforce the provisions of the Assistant Secretary of Defense (Production and Logistics) memorandum, dated March 30, 1990, subject: "Uniform Materiel Movement and Issue Priority System (UMMIPS) Processing," and conduct an internal review of the effectiveness of that policy change not later than July 1991. If that review reveals that the policy change has been ineffective, it is to be accompanied by recommendations for additional enforcement mechanisms to be implemented. The Office of the Secretary of Defense will make a decision at that time concerning the additional measures that may be necessary to rectify problems with abuse of the requisitioning priority system.

RECOMMENDATION 3: The GAO recommended that the Secretary of Defense direct the Secretary of the Army to discontinue the policy of assigning a predetermined high priority to all requisitions submitted under the Total Package Fielding Program. (p. 19/GAO Draft Report)

DoD Response: Concur. Not later than the first quarter of 1991, the DoD will direct the Army to implement the Principal Deputy Assistant Secretary of Defense (Production and Logistics) memorandum, dated March 30, 1990, subject: "Uniform Materiel Movement and Issue Priority System (UMMIPS)" relative to the Total Packaging Fielding requirements. That memorandum requires ordering activities to separate their materiel allocation priorities from their transportation priorities when they submit requisitions. The DoD direction will require the Army to limit the use of priority 05 to the materiel allocation segment of the Total Package Fielding requisitions.

With Total Package Fielding, ordering activities need high priorities to penetrate protected levels of stock in order to ensure that an adequate percentage of packages are filled on time. However, they do not need high priority handling of materiel within the Defense Logistics Agency depots or high priority shipments to the assembly points. Once a package has been assembled, the priority of shipment can be assessed on a fielding-by-fielding basis. The norm should be low-priority, surface shipments.

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