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DEFENSE INFRASTRUCTURE

Enhancing Performance Through Better Business Practices

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to report on the Department of Defense's (DOD) progress in reducing the defense infrastructure and improving financial management operations. DOD faces huge challenges in effectively managing its diverse operations as it downsizes its forces and activities. Critical to the downsizing process is having meaningful and reliable financial information so that DOD managers can make informed decisions. Today, I will present examples of DOD's progress in reducing the infrastructure and identify opportunities for eliminating unnecessary overhead by adopting better financial management and business practices. To the extent infrastructure resources are used inefficiently, they are not available to meet other defense needs.

BACKGROUND

According to DOD's bottom-up review, infrastructure activities accounted for $160 billion in fiscal year 1994 (approximately 59 percent of DOD's obligational authority) and include depot maintenance, supply operations, transportation, medical treatment facilities, personnel recruiting, training, and base operations. In fiscal year 1980, DOD's budget authority in constant 1996 dollars was $261 billion, and DOD had about 2.1 million active duty military personnel. In fiscal year 1999, DOD's budget authority in constant dollars is projected to be about $235 billion and DOD will have only 1.45 million active duty military personnel. That means DOD will be spending about $38,000 more per soldier in 1999 than it did in 1980, and operation and maintenance represents 56 percent ($21,277) of that increase per soldier.

RESULTS IN BRIEF

DOD has not reduced its infrastructure at a rate commensurate with reduced force levels. While military personnel end strength is projected to decline by 28 percent and procurement by 59 percent from fiscal year 1990 to fiscal year 1996, operations and maintenance funding for infrastructure is projected to decline by only about 13 percent. (See attachment 1 showing DOD spending by major category).

DOD has reduced its infrastructure in some areas. However, in too many cases, intended reductions have not materialized. DOD promised billions of dollars in savings through the Defense Management Report (DMR) and the Corporate Information Management (CIM) initiative, which generally have not achieved the magnitude of savings expected. As a result, scarce resources are being used to fund inefficiencies. The Defense Business Operations Fund (DBOF) has not given managers the financial information they need to make better business decisions. Regarding successes, DOD calculates that the base closure and realignment rounds in 1988, 1991, and 1993 resulted in decisions to close 15 percent of its

major domestic bases, and it projects that its recently released list of 1995 base closures and realignment recommendations will increase closures to 21 percent. Reductions in military and civilian personnel during this time have been much steeper and are slated to reach 32 percent within the next several years. In addition, DOD has achieved some inventory reductions, initiated some pilot projects, and recognized that it must improve its inventory management.

By making greater use of innovative approaches and best management practices, DOD could achieve greater cost reductions--hundreds of millions, possibly billions, of dollars, in the short term. A number of opportunities should be implemented immediately. For example, in the inventory area, operation costs could be saved if DOD established supplier parks, which could reduce wholesale and retail storage and handling costs and minimize retention of excess and obsolete inventory. Benchmarking with private sector companies and reengineering show potential for DOD to cut costs in several areas, including some finance and transportation functions. Over the longer term, tackling the management deficiencies in the defense infrastructure is a formidable challenge. Better business decisions can be made only with accurate and reliable financial information and leaders that are willing to take on the inherently painful task of changing the way business is done. Otherwise, ineffective systems will continue to undermine military force capabilities.

PROMISE OF BIG SAVINGS HAS NOT MATERIALIZED

DMR

In 1989, the DMR proposed a series of consolidations and management improvements that were estimated to save up to billions of dollars in support and overhead programs. The report resulted in about 250 decisions to implement consolidations, improve information systems, enhance management, and employ better business practices. The projected savings from individual initiatives ranged from a few million dollars to over $10 billion. Total savings estimates for the 1991-97 period were as high as $71 billion. However, as previously reported, tracking and validating savings to specific initiatives has proven difficult.[1] Moreover, the extent to which savings have resulted from the initiatives or from other factors, such as defense downsizing, could not be determined.

CIM

CIM, initiated about 5 years ago, is intended to reengineer common business processes across DOD by (1) implementing new or improved business methods for common functions and (2) improving the

[1]Defense Management Review (GAO/NSIAD-94-17R, Oct. 7, 1993).

standardization, quality, and consistency of systems and data for DOD's management information systems. However, CIM has yielded marginal results to date. DOD estimated that implementation of CIM would save billions of dollars through reengineering and process improvements. However, as we reported previously, DOD does not know how much of the $9 billion spent annually on automated data processing is attributable to CIM.[2] We also believe that DOD is making some questionable investments in systems modernization, which amounts to about $3 billion a year. I will discuss our concerns about this later in the testimony. Last year, following this Subcommittee's initiative, Congress directed DOD to take actions to mitigate CIM's high risk. DOD was to respond to you on March 15, 1995.

One of the techniques that DOD is using to accomplish CIM objectives is reengineering, which, in brief, calls for organizations to critically evaluate their key activities (called processes) that span across the entire business, use integrated (cross-functional) teams to redesign processes to eliminate unnecessary or nonvalue-added tasks, and then, lastly, acquire or develop technology to implement the redesigned process. Our ongoing work on the reengineering practices of some private sector companies demonstrates that reengineering has been used successfully by businesses as they have attempted to become more competitive in the global marketplace in a downsizing environment.

Contrary to private sector reengineering practices, DOD has primarily focused its efforts on trying to pick the best of its existing automated systems and standardizing their use across the military components prior to redesigning the process. As we previously reported, we believe that selecting technology alone creates the risk that DOD may be wasting money modifying and implementing systems to support old, inefficient ways of doing business.[3] DOD believes that selecting a common set of business information systems is necessary to make functional integration and interoperability possible so that all DOD activities can work together more efficiently and effectively.

While there are improvement initiatives taking place throughout DOD, many tend to be incremental efforts being developed in isolation from other efforts and do not offer the type of dramatic improvement that is possible through reengineering. In addition, CIM is just one of the many management improvement initiatives in DOD, and it is difficult to determine whether a change relates to

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[2]Defense Management: Stronger Support Needed for Corporate Information Management Initiative to Succeed (GAO/AIMD/NSIAD-94-101, Apr. 12, 1994).

[3]Defense Management: Impediments Jeopardize Logistics Corporate Information Management (GAO/NSIAD-95-28, Oct. 21, 1994).

CIM or other efforts, such as base closures, acquisition reform, or the Defense Performance Review. Furthermore, the Secretary of Defense, in a September 1994 memorandum, challenged each department and agency to take a fresh look at their high payoff processes and develop--through reengineering techniques--truly innovative approaches to the performance of missions and functions. However, the stewardship for this new initiative is the Director of the Defense Performance Review. This further confuses CIM's reengineering mission and may contribute to functional managers' view that CIM is primarily an information technology initiative as we stated previously in the logistics CIM report (see footnote 3). We are also concerned that overlapping or conflicting initiatives consume valuable resources that are needed to implement and integrate improved DOD-wide business processes.

CREDIBLE FINANCIAL INFORMATION IS KEY TO ANALYZING INFRASTRUCTURE REDUCTION OPTIONS

We recently identified DOD's financial management as a high-risk area in the federal government.[4] We characterized DOD's financial management operations as "the worst in government and the product of years of neglect." In presenting the fiscal year 1995 budget, Secretary of Defense Perry said, "Our financial management . . . is a mess, and it is costing us money we desperately need." Part of the problem can be attributed to DOD's operating a myriad of nonstandard financial systems. For example, during a 6-month period, hundreds of contractors returned about 4,000 checks totaling $751 million, of which $305 million was in overpayments. The overpayments were voluntarily returned by the contractors. In addition, we have reported financial management weaknesses in DBOF that will hinder DOD's efforts to identify and reduce its operating costs. Specifically, DBOF deficiencies affect Defense managers' ability to identify how much existing processes cost; thus, managers can only estimate the cost or use unit costs that cannot be verified. Without accurate and reliable information, it is difficult to compute exactly what new processes will cost and whether the savings are worth the effort.

DBOF

Designed to give managers the financial information they need to make better business decisions, DBOF is not working as intended. A key element in reducing the cost of operations is the ability to accurately identify total costs. However, DOD lacks the management tools to accomplish this task. We recently reported that DOD has not adequately managed the Fund's cash, improved the accuracy and reliability of the Fund's systems, and improved the Fund's monthly

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[4]High-Risk Series: An Overview (GAO/HR-95-1, Feb. 1995).

financial reports.[5] These concerns are described in more detail below.

Since the Fund was established, its cash balance has been centrally managed by the Office of the Secretary of Defense (Comptroller). On February 1, 1995, DOD returned the management of the Fund's cash to the military service and DOD component level. This policy change is a major departure from the benefits of a single cash balance DOD cited in establishing the Fund. In the March 1991 Defense Business Operations Fund Overview Book on the budget, DOD informed the congressional defense committees that "combining previously separate appropriations into one account, united by support and business function aspects, allows lower total fund balances through a form of self-insurance not previously available. Operation fund balances for the former stock and industrial funds are significantly reduced in this budget." However, DOD began experiencing cash shortages in June 1993 and decided to advance bill customers to avoid a negative cash balance. The policy change could further exacerbate the Fund's cash problems. While this change returns to the old way of doing business, where each service had separate stock and industrial funds, now each service has one fund plus a DOD-wide and an Office of the Secretary of Defense corporate fund. We believe DOD should reverse this cash management policy. Maintaining the accountability for cash management at the Office of the Secretary of Defense level would reduce the amount of cash needed to operate the Fund.

One of the primary challenges still confronting DOD is the improvement and standardization of DBOF's financial systems. Currently, about 80 disparate and unlinked systems are producing accounting data that is not accurate and reliable. Accurate cost data are critical to develop a systematic means to reduce the cost of operations. The 17 systems recommended as interim migratory financial systems for DBOF will cost $94.5 million, according to DOD, to enhance them to meet minimum functional requirements. However, this cost does not include the following significant items: (1) improvements needed to meet the minimum technical requirements; (2) data conversion from the existing systems to the interim migratory systems; (3) development of interfaces with nonfinancial systems, such as logistics and personnel, that generate most of the financial data; (4) training of personnel who will operate and enter data into the interim migratory system; and (5) replacement of 63 existing systems with the interim migratory systems. Given the magnitude of the total cost to upgrade the systems, the DOD Comptroller should not expend funds, except for normal routine maintenance, to enhance the existing Fund systems until a functional economic analysis is prepared for each of the recommended Fund interim migratory systems.

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[5]Defense Business Operations Fund: Management Issues Challenge Fund Implementation (GAO/AIMD-95-79, Mar. 1, 1995).

DOD's plan for improving Fund operations identifies a number of actions aimed at improving the accuracy of the financial reports, including revising the monthly report of operations. Officials responsible for completing the new report said that it could not be properly prepared because current financial systems did not contain or accumulate all the necessary data. As a result, the centers had to manually input data. DOD components need to work together and agree on the actual sources of information to be used to produce the financial reports and prepare audited financial statements for each of the Fund business areas.

OPPORTUNITIES TO REDUCE INFRASTRUCTURE AND IMPROVE SERVICE

Infrastructure reductions, particularly in high cost areas like depot maintenance, inventory, and finance, have not kept pace with the force downsizing. This is critical, since the savings derived from reducing infrastructure can be used for higher priority defense needs. Thus, reductions in these areas need to be aggressively pursued to achieve the necessary dramatic gains in improving defense operations. I would first like to address some major areas that would yield savings over a longer term and then address those that show more immediate opportunities for savings.

Longer Term Opportunities for Savings

Base Closures

DOD anticipates that the realignment and closure of military bases and facilities will result in significant savings. However, opportunities have not been fully realized, particularly in the 1995 round. Since 1988, DOD has decided to fully or partially close 70 major domestic bases and to close, realign, or otherwise downsize scores of other bases, installations, and activities through the base closure and realignment process. DOD's goal for the 1995 round was to reduce the overall DOD domestic base structure by at least 15 percent of DOD-wide plant replacement value--an amount at least equal to the three previous base closure rounds. DOD projects that its recently released list of 1995 base closures and realignments will increase the percentage to 21 percent, not the 30 percent that would have been required to meet it goals. The 1995 recommended closures and realignments are fewer than expected, and the need for more closures in years ahead is likely.[6] In addition, DOD estimated that it would realize $4.1 billion in property sales revenue from military bases closed under the 1988 and 1991 base realignment and closure rounds. In 1994, DOD reduced this estimate to $1.2 billion. Revenue from property sales is to be used to help pay for the base closure

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[6]Military Bases: Challenges in Identifying and Implementing Closure Recommendations (GAO/T-NSIAD-95-107, Feb. 23, 1995).

costs. Property sales had produced revenues of $69.4 million; an additional $22.2 million is expected from pending sales.[7]

Depot Maintenance

DOD's depot management structure has not resulted in substantial competition, interservicing, or reduction of excess capacity and duplication of effort.[8] Each service maintains its own depot maintenance structure that provides for major overhaul of parts, rebuilding parts and end items, modifying systems and equipment by applying new or improved components, and manufacturing parts unavailable from the private sector. In May 1994, the Deputy Secretary of Defense directed the Secretaries of the Navy and Air Force to work together to consolidate the services' workloads, reduce excess capacity, use the most proficient DOD depot to perform depot maintenance, and strongly consider joint depot management and joint operations alternatives. No such results were achieved. Furthermore, few cross-servicing solutions are being forwarded in the 1995 base closure process. Eliminating additional excess capacity and unnecessary duplication and more cost-effectively managing DOD's depot maintenance operation will continue to be issues.

Inventory

For more than a decade, leading businesses have been streamlining inventory processes and stocks on hand to reduce overhead, increase responsiveness, and cut unnecessary carrying costs. DOD has begun to take advantage of this opportunity, which I will discuss later. However, much work still needs to be done. We continue to designate inventory management as a high risk area. DOD's excessive inventories of unneeded items have resulted largely from a culture that believed it is better to overbuy items than to manage with just the amount of stock needed. DOD often stores inventories in as many as four different layers between suppliers and end users. Storing inventory in multiple layers results in inventory that turns over slowly and produces large amounts of old, obsolete, and excess items. In September 1993, DOD reported that its secondary inventory was valued at $77.5 billion. However, of that amount, about $36.3 billion in inventory was not needed on hand to support DOD's war reserves or current operating requirements. DOD has wasted billions of dollars buying supplies that have become excess, burdened itself with maintaining them, and failed to acquire the tools or expertise needed to manage them effectively. This culture has been slow to adopt new management

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[7]Military Bases: Reuse Plans for Selected Bases Closed in 1988 and 1991 (GAO/NSIAD-95-3, Nov. 1, 1994).

[8]Depot Maintenance: Issues in Management and Restructuring To Support a Downsized Military (GAO/T-NSIAD-93-13, May 6, 1993).

practices, technologies, and logistics systems that would result in storing only those items necessary to support operations. DOD has also failed to provide its personnel with the tools and incentives to manage the inventory properly.[9]

Furthermore, DOD continues to lack financial accountability and control over its inventory because it (1) does not have accurate, reliable data to support the quantity, condition and value of items and (2) does not have integrated systems to provide accurate data. DOD recognizes these weaknesses and is taking some corrective action.

Information Technology Management

Reengineering and modern technology offer huge opportunities to reduce defense costs and improve the quality of service. While CIM, as previously mentioned, was intended to harness this area somewhat and steer efforts toward a common purpose, information technology management remains such a growing concern that we added a new category--information systems modernization efforts--to our own list of high-risk areas that we monitor. DOD has invested heavily in costly information systems, within and outside the CIM umbrella, that have failed to produce dramatic service improvements or significant reductions in costs. While well-intentioned system modernizations are underway across DOD, many are at great risk due to the failure to use technology to simplify and reengineer processes in ways that reduce costs, increase productivity, and improve service.[10] For example, in our ongoing work we noted that DOD is developing the Depot Maintenance Standard System to support its efforts to streamline depot maintenance operations and manage resources more effectively at its repair depots. However, implementing the system, if successful, will provide only incremental improvements that are expected to reduce depot maintenance costs by less than 2.5 percent over a 10-year period. Because DOD does not plan to reengineer depot maintenance processes until after the Depot Maintenance Standard System is fully deployed, it has delayed achievement of potential improvements for at least 8 years.

Near Term Opportunities for Savings

Our work also shows a number of areas where DOD could reduce infrastructure costs and improve the quality of service in the near term by adopting new business practices and improving its use of information technology. DOD needs to aggressively pursue

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[9]High-Risk Series: Defense Inventory Management (GAO/HR-95-5, Feb. 1995).

[10]Government Reform: Using Reengineering and Technology to Improve Government Performance (GAO/T-OCG-95-2, Feb. 2, 1995).

alternatives such as outsourcing, using civilians in place of military personnel, and cutting layers of unnecessary overhead.

Finance

In 1991, DOD created the Defense Finance and Accounting Service (DFAS) to strengthen its financial management operations and to achieve savings by standardizing, consolidating, and streamlining finance and accounting policies, procedures, and systems. DFAS has explored several consolidation initiatives and recently announced plans to consolidate over 300 defense accounting offices into 5 large existing finance centers and 20 new sites called operating locations. If successful, the consolidation will allow DFAS to reduce finance and accounting personnel in DOD from 46,000 to about 23,000. According to DFAS, consolidation alone, however, will not result in these productivity gains, it must also reengineer and standardize its processes and systems so that it needs fewer people to perform finance and accounting functions.

In our ongoing work we noted that DOD's decision to create 20 new operating locations may result in a finance and accounting infrastructure that is larger than necessary. Under a previous consolidation initiative, for example, DOD planned to consolidate all accounting and finance activities into 5 large centers. More recent DOD analyses indicate that the 5 large centers plus 6 additional operating locations would be sufficient. DOD decided against this option, however, because it reasoned that 20 small offices (with about 750 people each) could be opened rather quickly. This would allow it to transfer the workload from the 300 defense accounting offices and begin to realize budgetary savings sooner than other alternatives. Even though DOD might save money in the short term, our preliminary analysis shows that the current consolidation plan will require up to 3,500 more personnel, cost $2.8 billion (net present value) more to operate over the next 20 years, and require about $173 million in military construction funding in fiscal years 1997, 1998, and 1999.

We also noted that DFAS is attempting to achieve productivity improvements by standardizing and improving some of its financial management systems and processes. It also plans to reengineer these systems and processes some time in the future but not until the consolidation is complete and the standard systems and processes are operational. As a result, DFAS will likely achieve some productivity gains but not to the extent possible if reengineering were more of a priority. For example, under DFAS's current civilian payroll operations, each employee handles about 684 pay accounts. Once DFAS standardizes its civilian pay systems, it expects that each employee will be able to handle about 1,800 pay accounts each. While this is a substantial productivity gain, private sector companies that have aggressively reengineered their employee pay functions average about 3,000 pay accounts each. If DFAS could achieve this level of productivity, the number of

employees needed for civilian payroll functions could be reduced by an additional 470 people. This would save DFAS about $16 million more in annual operating costs and possibly reduce the number of locations needed to perform civilian pay operations.

Finally, DFAS has not yet selected standard systems for several of the finance and accounting functions that it plans to put at the 20 new operating locations (e.g., general funds accounting, vendor pay, travel). As a result, the consolidation will likely perpetuate many of the old, inefficient, and unneeded processes; lock DOD into ways of doing business that may not serve future operations; and result in a larger finance and accounting infrastructure than necessary. Coupled with the fact that most of the DFAS employees at these locations will be new hires, it is unlikely that any real productivity gains can be achieved in these locations for some time.

Benchmarking the DFAS freight payment process may also provide additional opportunities to save money. We previously reported that DFAS's unit cost of $5.70 per bill for freight payment services was high compared to third-party logistics firms that could provide a similar service.[11] Two firms proposed to perform freight payment (freight bill processing, pre-auditing, verifying, and generating management reports with payment) for DOD at a cost ranging from $0.75 to $1.25 per government bill of lading, depending on whether the freight bills were transmitted on paper or electronically.

Modernization Systems

Under the CIM initiative, DOD has focused on trying to pick the best of its existing automated systems and standardizing their use across DOD. Furthermore, in October 1993, DOD adopted an accelerated implementation of this "migration" strategy. Specifically, DOD was to select migration systems within 6 months and transition to these systems over the next 3 years DOD-wide. Despite the priority given to this initiative, the military services and Defense agencies have yet to complete the necessary implementation plans and the technical and economic assessments showing how DOD's fiscal year 1996 information technology modernization request of about $3 billion will be spent, including DOD's return on investment. Consequently, we believe DOD's request for modernization systems represents a high-risk investment.

Transportation

Numerous studies by DOD, commissions, even the U.S. Transportation Command (TRANSCOM) have reported that the structure of the

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[11]Defense Transportation: Commercial Practices Offer Improvement Opportunities (GAO/NSIAD-94-26, Nov. 26, 1993).

transportation system is fragmented and inefficient. Traffic management processes and automated systems were developed independently for each mode of transportation. The entire defense transportation system was built along service and modal lines--the Army's Military Traffic Management Command for land transportation and port operations, the Navy's Sealift Military Command for sealift; and the Air Force's Military Airlift Command (now the Air Mobility Command) for airlift. In 1987, TRANSCOM was established to unify defense transportation under a single manager during war and to resolve problems inherent in having several managers controlling DOD cargo. It was not until 1993, however, that DOD designated TRANSCOM as the single DOD manager of the Defense Transportation System in both peace and war. Today, TRANSCOM finances over $5 billion of transportation expenses, which includes overhead. However, the current structure of separate component command headquarters and a worldwide field structure has remained essentially unchanged since the formation of TRANSCOM. Transportation services that the military component commands have traditionally provided, such as port handling and intermodal transfers, are being handled primarily by commercial carriers. Component field offices are part of an antiquated system that moved cargo by separate modes and required on-site personnel at modal transfer points. This extensive infrastructure is costly. For example, a military customer is charged $2,624 for a shipment from New Jersey to Rotterdam, Netherlands; yet a commercial carrier charges $1,553 for the shipment. The added cost to the customer of $1,071 (or 69 percent of the carrier's charge) represents the overhead amount charged to the customer.

TRANSCOM recognizes that it needs to reengineer the transportation system and achieve its goal to develop a fully integrated, joint, intermodal transportation system, maximizing support to its customers, and is actively engaged in a reengineering initiative. However, TRANSCOM may not realize its vision unless it addresses its organizational structure. In addition, the success of the reengineering effort relies heavily on its ability to field an integrated and global defense transportation information system. Under the CIM initiative, TRANSCOM's Joint Transportation CIM Center is identifying systems for development and enhancement and is recommending reducing 120 systems to 23 migration systems or less by 1997. However, standardization of systems is taking place prior to reengineering transportation processes, which could perpetuate inefficient and unneeded processes. TRANSCOM's reengineering implementation plan states that it will conduct a future review of all defense transportation system organizations, including an assessment of the role and requirement for transportation component command and subordinate commands. While our work is incomplete at this time, we believe fixing the organizational structure is a mandatory first step to address the fragmented transportation system and substantially reduce transportation costs.

Printing

The Defense Printing Service is DOD's single manager for printing and duplicating operations. It was established in April 1992 when the printing-related operations of the military services and defense agencies were consolidated. The Defense Printing Service sends the majority of its printing work to private vendors on contract to the Government Printing Office and maintains most of its duplicating work in-house. Our work showed that larger printing and duplicating jobs (those over $500) are generally less expensive through contracting, while the smaller jobs are less expensive when produced in-house. We believe more can be saved ($20 million to $30 million) by contracting out additional work, assuming suitable term contracts can be established with private vendors. The Defense Printing Service has identified at least $80 million of in-house work that could be contracted out without adversely affecting its mission.

Hardware Inventory

The Defense Logistics Agency's (DLA) adoption of best practices for reducing consumable items is the least advanced for hardware items, which represent 77 percent of DLA's total inventory. (See attachment 2, showing DLA commodities). Although DLA is examining the potential application of some commercial practices for hardware items, DLA's progress is slow and results are limited. As we previously reported, the private sector has applied innovative practices at industrial centers, where it uses large quantities of consumable hardware items such as bearings, valves, and fasteners to maintain and repair its equipment.[12] According to private sector officials, these items offer the greatest opportunity for reduction because they are generally standard, used in large quantities, and are commonly stocked by several suppliers. Through a supplier park concept, private sector companies have significantly reduced similar types of inventories and the costs to manage and store them. For example, two companies we examined--PPG Industries and Bethlehem Steel--have used supplier parks and other similar concepts to eliminate as much as 80 percent of their consumable item inventories. In addition, these companies estimate that they have saved millions in related operating costs.

DLA recently began a study to examine the applicability of using supplier parks or similar techniques at service maintenance and repair facilities. Like the private sector, DOD operates industrial facilities that use large quantities of consumable items to repair and maintain its aircraft, land vehicles, and ships. A significant portion of DLA's inventory is invested in these items.

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[12]Commercial Practices: DOD Could Save Millions By Reducing Maintenance and Repair Inventories (GAO/NSIAD-93-155, June 7, 1993).

For example, in 1992, DLA had invested over $2 billion in bearings, tubes, hoses, valves, nuts, and bolts. By using supplier parks, DOD could shorten the time end users need to order and receive items to a few hours. In doing so, DOD would reduce both wholesale and retail storage and handling costs and minimize the retention of excess and obsolete inventory. The result would be a reduced need of on-hand inventory and warehouse space.

Civilians in Military Support Roles

Thousands of military personnel perform support functions, such as personnel management and data processing, that are typically performed by civilians and do not require skills gained from military experience. We previously reported that using civilians for such functions could reduce peacetime personnel costs and/or release military members for more combat-specific duties.[13] Cost differences between military and civilian personnel in peacetime support functions vary by pay grade; however, on average, a civilian employee costs about $15,000 less per person per year than a military person. Our preliminary analysis shows that over $2 billion a year could be saved in personnel costs if the services eliminated about 148,000 military positions and used civilian employees in support positions in 24 occupational specialties. The 148,000 military positions would result if all the services achieved a civilian-to-military personnel ratio equal to the service with the highest ratio. The ratios vary depending on the job specialty and range from 18 percent in the Army for food service personnel to 100 percent in the Navy for motor vehicle operators. Additional savings could be achieved if more civilians were used in specialties other than the 24 we examined.

Contractor Personnel

DOD civilians as well as contractor personnel can play important roles in deploying to theaters of operation. Civilian employees and contractor personnel have historically supported the military forces in wartime theaters of operation. DOD reports that over 5,000 DOD civilian employees and nearly 9,200 contractor personnel voluntarily deployed to the Persian Gulf area to support the military forces during the Gulf War. While some administrative problems were associated with these deployments, DOD did not indicate such deployments were a bad idea--only that proper planning is required. During the Cold War, U.S. plans of support in a European theater of operation included reliance on host nation support, some of which was from civilians. In today's environment, with a less clear threat and a greater potential for military actions to occur in what are known as immature theaters of

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[13]DOD Force Mix Issues: Greater Reliance on Civilians in Support Roles Could Provide Significant Benefits (GAO/NSIAD-95-5, Oct. 19, 1994).

operation where support capabilities must be installed, host nation support is less of an option.

ADOPTION OF BETTER BUSINESS PRACTICES IS ESSENTIAL TO REDUCING INFRASTRUCTURE

An efficient set of business operations supporting this vast and diverse infrastructure is critical to getting the most from the dollars spent on readiness. Otherwise, ineffective systems will continue to use dollars that could be spent on other military force capability needs. DOD generally agrees that it could lower costs and reduce inventories, for example, by using commercial practices. DLA has improved its management of some commodities by adopting better business practices. DLA began making improvements in the way in which it bought and stored inventory to compete with private sector logistics systems. DLA's traditional system contained high overhead charges, and supplies were often not delivered to the customer in a timely, cost-effective fashion. As a result, military medical treatment facilities bought as much as 50 percent of medical supplies from sources outside the DLA distribution system. DLA realized that it needed to change the way it did business and decided to use commercial distribution networks, or "prime vendors," to regain lost customers and sales. Prime vendors substantially reduced the need for DOD to store and distribute inventory to its approximately 150 hospitals and medical treatment facilities nationwide, reduced logistical costs, and improved customer service. (See attachment 3, showing process improvements using the prime vendor program). Since September 1991, DLA has reduced wholesale medical inventories by $365 million, partially due to the prime vendor program ($49 million) and elimination of obsolete and unnecessary inventories ($316 million). In addition, DLA is implementing a pilot program to have private sector food distributors deliver food directly to dining facilities rather than to defense storage facilities. Through this change, DLA anticipates about a 75-percent decline in peacetime inventory levels and improved customer service.

Elements of Successful Reengineering

Many of the reasons for success in DLA's initiatives we also found in our work on how the private sector achieves radical change.[14] Private sector experience points to reengineering as an effective way to streamline management processes. Generally, successful steps in reengineering include a thorough understanding of an organization's customers, their needs, and the environment; top management, usually the chief executive officer, recognizes the need for change; the top managers define the strategic business

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[14]Reengineering Organization: Results of a GAO Symposium (GAO/NSIAD-95-34, Dec. 13, 1994).

case for change, including a return on investment; and reengineering efforts are focused on process instead of functions.

Since reengineering is inherently painful for the organization, top management must be committed to it and willing to demonstrate its commitment in order for reengineering efforts to succeed. Top management also promotes organizational efficiencies: limiting duplication of efforts between functions; resolving cross-functional conflicts, which are inherent in an effort of this type; spreading lessons learned throughout the organization; and ensuring the effort is aligned with and tied to strategic and business goals.

In implementing the prime vendor program, for example, DLA established a high sense of urgency and was able to begin making changes in a relatively short time. DLA officials estimated that it took about 10 months to establish the first prime vendor program in the national capital area and about 2 years to expand the program to all of its medical treatment facilities nationwide. In addition, the commitment and involvement from top management effectively removed barriers to accomplish these changes.

While there are pockets of successful efforts, DOD has not consistently been able to make significant progress in other critical areas. Making change seriously challenges entrenched bureaucracies and longheld beliefs and values.

COMMITMENT TO CHANGE IS NEEDED TO REALIZE SAVINGS

The funding for infrastructure activities is substantial. For example, 5 percent of the $160 billion defense infrastructure represents about $8 billion in purchasing power that equates to (1) almost twice the cost of the CVN-76 aircraft carrier (estimated at $4.6 billion) or (2) about 6 times the cost of the sixth Milstar satellite (estimated at $1.3 billion).

Having said that, I would like to add that DOD needs to be realistic in determining what it can accomplish in reducing infrastructure and avoid making projections and savings estimates that cannot be substantiated as it has in the past with CIM, for example, and again in estimating its future years budget needs. As we recently reported, our review of the 1995-99 future years defense program revealed a substantial amount of risk that has resulted in overprogramming.[15] Overprogramming occurs by overstating savings and understating costs and includes more programs in the future years defense program than spending plans will support. Such a practice can obscure defense priorities and delay tough decisions and trade-offs.

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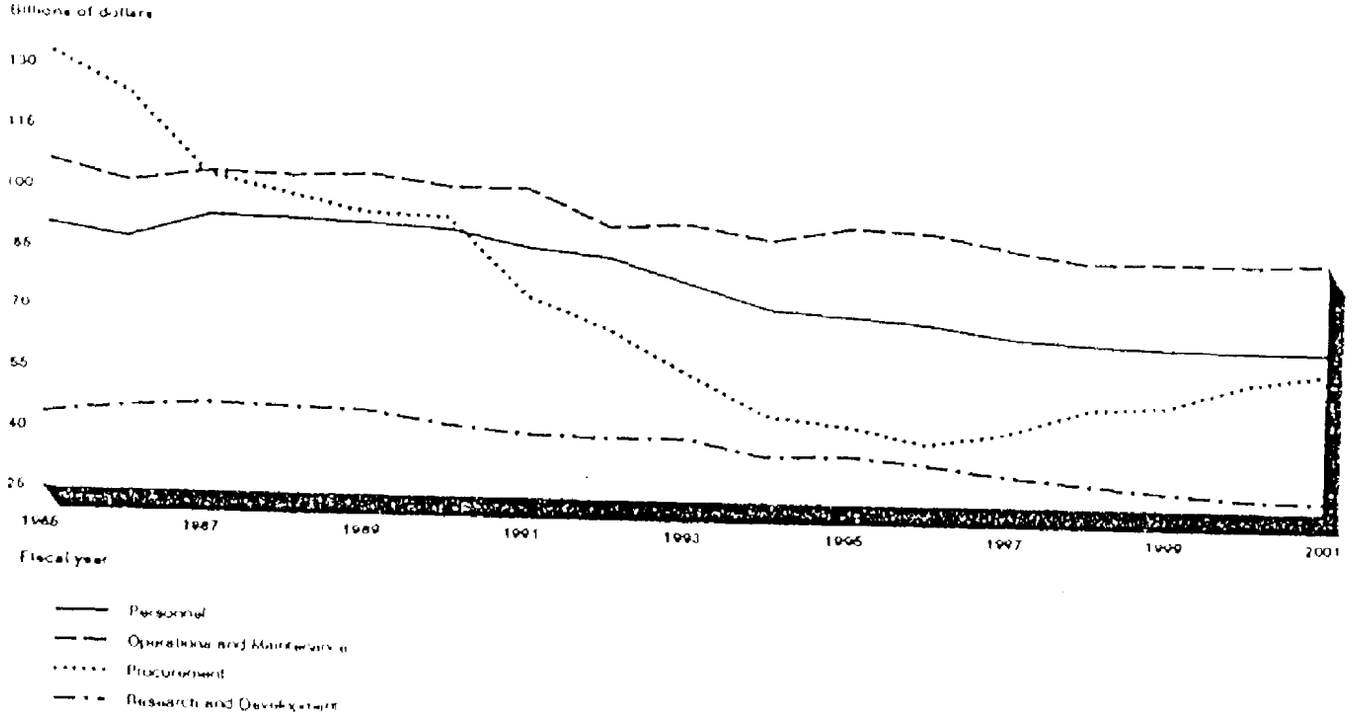
[15]Future Years Defense Program: Optimistic Estimates Lead to Billions in Overprogramming (GAO/NSIAD-94-210, July 29, 1994).

We believe there are opportunities to save money by "outsourcing" or privatizing some of the non-core functions that DOD is currently handling, especially those functions where there is a competitive commercial market. However, each one of these areas would need to be looked at and analyzed individually to determine how much if any could be privatized consistent with the requirements of various laws and regulations. While turning these areas over to the private sector in whole or in part may potentially save the government money, it can also pose some risk that needs to be recognized. First, the readiness implications need to be considered to ensure that there would be no adverse impact. Second, economic analysis needs to be conducted to determine that the change would not cost DOD more money and would in fact save money. For example, if there is excess capacity at a depot that is privatized, then turning more of the workload over to the public sector would increase the overhead cost of the organic depots for the work that remains. Finally, DOD would need to exercise strong management over the selection and monitoring of contractors to ensure that the commercial provider met specific performance targets.

In a February 1995 speech before the American Defense Preparedness Association, the Chairman of the Commission on the Roles and Missions of the Armed Forces stated: "One thing is very clear today: DOD must change." We agree wholeheartedly with that statement. One way to change is through business process reengineering, which can achieve dramatic cost, quality, and customer service by making fundamental changes in a way an organization defines its mission and performs its work. Reengineering typically involves undertaking a risky, innovative venture, which is not generally encouraged within the federal government. Federal managers have little or no incentive to make difficult and personally disruptive changes that are associated with reengineering, particularly if their budgets will be reduced by the amount of projected savings. DOD and Congress need to work more as partners to involve the services and defense agencies in the change process and convince them through some type of incentive that savings from improvements will be used to enhance DOD's business functions or military capabilities.

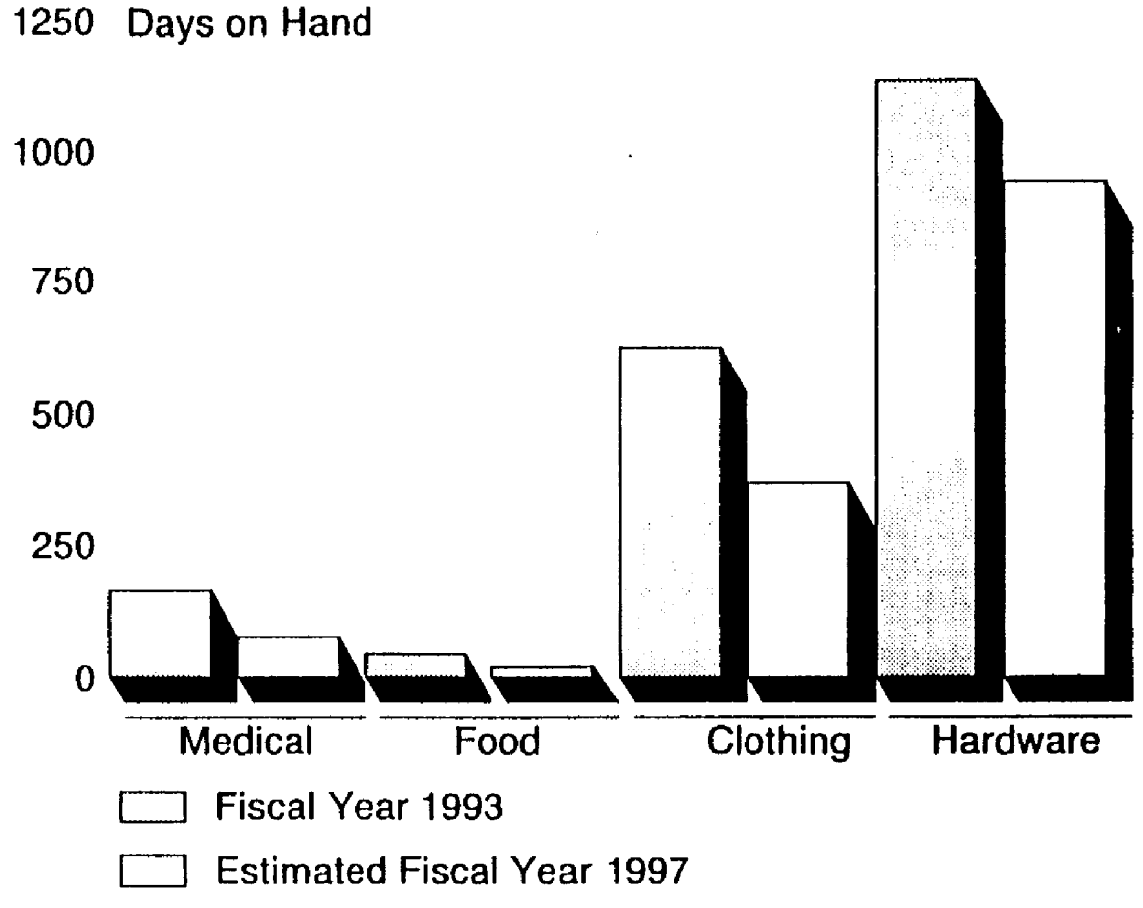
Mr. Chairman, this concludes my testimony. We would be glad to answer any questions that you or other members of the Subcommittee may have at this time.

DOD Spending by Major Category



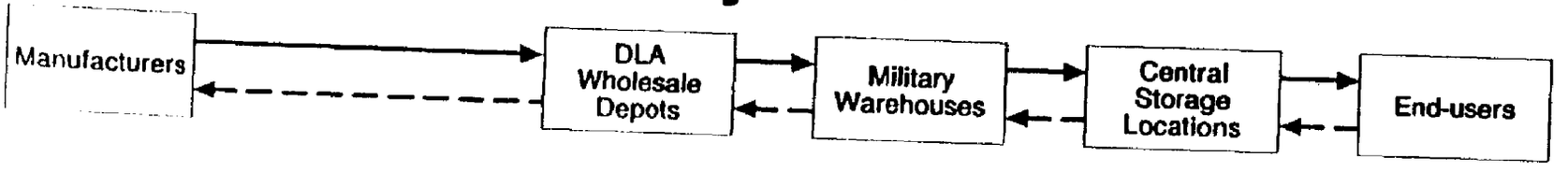
Source: U.S. Office of Management and Budget, Budget of the United States Government, fiscal year 1996 and DOD briefing documents.

GAO All DLA Commodities

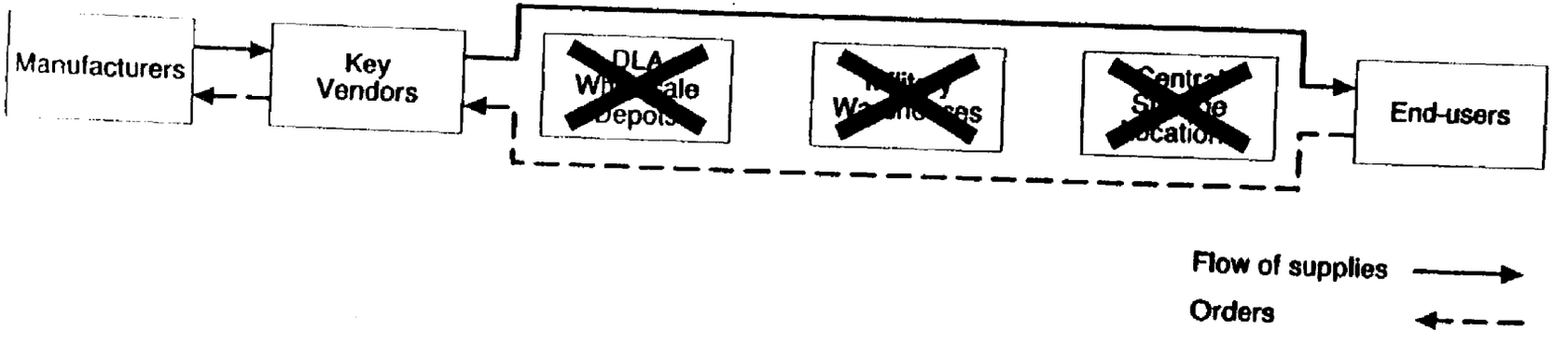


GAO Recommended Process Improvements

Traditional Logistics System



"Best" Commercial Practices



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