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FEDERAL PROPERTY DISPOSAL

Information on DOD's Surplus Property Program

Statement of David R. Warren, Director, Defense
Management Issues, National Security and International
Affairs Division



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the Department of Defense's (DOD) process for disposing of surplus personal property. Surplus personal property can be any items other than real property, which is land and buildings and items permanently attached to them. Personal property includes items such as aircraft parts, computers, furniture, and clothing. DOD maintains a complex disposal system that is characterized by massive volumes of excess property. In fiscal year 1996, for example, DOD disposed of millions of items with a reported acquisition value (the amount originally paid for the items or most recently paid for similar items) of almost \$24 billion. Our testimony today will focus on (1) an overview of how the disposal process works and how it differs from private sector disposal systems, (2) the means used to dispose of personal property, (3) efforts to improve the efficiency and effectiveness of the current disposal operation, and (4) opportunities to improve aspects of the disposal function through competitive outsourcing.

Summary

DOD's disposal process is governed by numerous laws and regulations that require DOD's surplus property be made available to many organizations. Thus, the best items are taken through the transfer and donation process leaving the least marketable items available for sale. This and other factors contribute to DOD's low rates of return. Although the private sector obtains higher rates of return than DOD for comparable items, it does not handle the quantities, types, and conditions of items that DOD does. Thus, the private sector is able to develop disposal expertise and tailor its disposal strategies so that it obtains higher rates of return.

DOD recognizes that it needs to improve its management of property disposal and has adopted or is planning to adopt a number of commercial practices that should help improve its operations. DOD is also involving the private sector in certain aspects of the process, particularly in the sales of surplus property, to improve its rate of return and become more business like in its operations. In addition, aspects of DOD's disposal process that are deemed to be not inherently governmental functions may be outsourcing candidates—an aim we supported in recent legislative proposals.

Background

The Federal Property and Administrative Services Act of 1949 (P.L. 81-152), as amended, placed responsibility for the disposition of

government real and personal property within the General Services Administration (GSA). GSA delegated the responsibility for disposal of DOD personal property to the Secretary of Defense, who in turn delegated it to the Defense Logistics Agency (DLA). DLA established the Defense Reutilization and Marketing Service (DRMS) to carry out the disposal function. Although DRMS disposes of the majority of items generated by DOD activities, certain categories of items, such as nuclear devices and cryptographic equipment, are disposed of by other means.

In fiscal year 1996, DRMS had about 170 Defense Reutilization and Marketing Offices (DRMO) worldwide that receive and dispose of personal property for DOD activities. It also employed about 3,700 people and disposed of millions of items with a reported acquisition value of almost \$24 billion.

Data Indicates Operating Losses and Low Rates of Return on DRMS' Disposal Operations

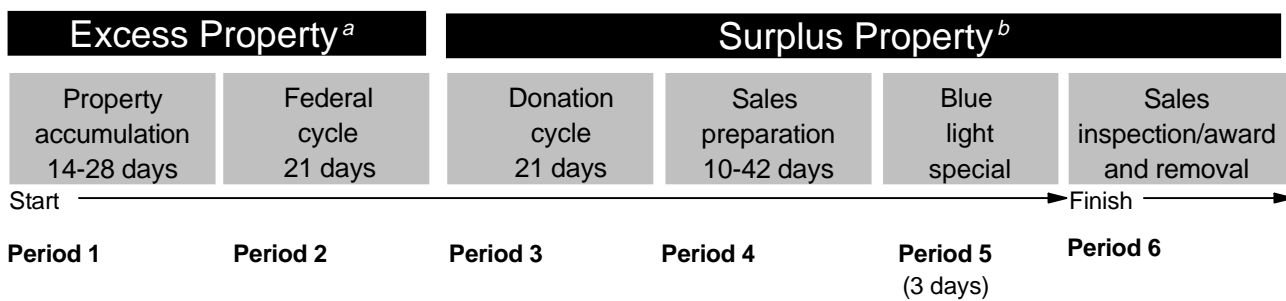
With a few exceptions, historical data indicates that DRMS has experienced operating losses in recent years and low rates of return on disposed items. For example, DRMS reported net operating losses in three of the four years from fiscal year 1993 to 1996. These losses ranged from a low of \$84 million in fiscal year 1996 to a high of \$153 million in fiscal year 1995. DRMS' overall rate of return on the reported acquisition value of all usable surplus property it sold in fiscal year 1996 was 1.97 percent. For fiscal years 1995 and 1994, the rates were 2.28 and 1.83 percent, respectively. DRMS calculates the rate of return by dividing the proceeds from the sale of usable items by the reported acquisition value of usable property sold. DRMS' overall rate of return is based on all usable items sold (excludes scrap).

The rates of return on property disposal at overseas DRMOs are higher than in the continental United States. For example, in fiscal year 1996, the rate of return for DRMOs in Europe was 6.98 percent, whereas the rate in the Pacific region was 2.88 percent. The higher rates of return at overseas DRMOs are primarily due to better items being available for sale because of fewer overseas transfer and donation customers. The lower rates in the Pacific region, as compared to Europe, are due to (1) bilateral agreements that give the host country "first right of refusal" (i.e., first opportunity to buy the items), (2) a smaller customer base, and (3) higher shipping costs incurred by customers due to longer distances.

DOD's Personal Property Disposal Process Is Guided by Legislation While the Private Sector Has Greater Flexibility

Figure 1 shows a general overview of the personal property disposal process. The disposal process, which is governed by numerous laws and regulations, starts when DOD activities turn in items to the DRMOs for disposal. Upon arrival, the items are inspected, condition and demilitarization (i.e., rendering an item militarily unusable) codes are verified; the type of sale is determined; and items requiring special handling such as hazardous material and precious metals are identified in order to apply extra controls. Items are accumulated for 2 to 4 weeks and then processed together. At anytime during the process, all customers may screen items and attach tags, indicating a desire to have them, but the items may only be issued and removed in accordance with established priorities. First priority is given to DOD activities, federal agencies, and other entities with legislative priority equal to DOD, such as certain law enforcement organizations and humanitarian relief agencies, among others. Second priority goes to approved donee organizations, such as state and local governments, museums, and Boy and Girl Scouts. Within these priorities, items are dispensed on a first-come, first-served basis. Customers have 14 days to requisition and 14 days to remove items, unless otherwise agreed with the DRMO. Items that are tagged but are not removed within the prescribed time frames are available for use by other qualified organizations during a 3-day period known as the “blue light special.”

Figure 1: The Personal Property Disposal Process



^aProperty not needed by DOD activities is considered to be excess and is available for reutilization by other DOD activities, transfer to other federal agencies, and transfer to organizations that have been given priority equal to that of the federal government for the purpose of obtaining excess personal property.

^bProperty not needed by the federal government or organizations with equal priority is considered surplus and is available for donation to eligible organizations or for sale.

Items that still remain after this part of the process has been completed are sold to the general public through three types of sales—international, local, and retail. International sales are used for items with global appeal, such as machine tools, or property that requires additional controls, such as hazardous materials. After several hundred items are accumulated, a catalog is published, and sealed bids are solicited. The high bidder for items requiring extra controls or demilitarization undergoes a clearance process before the award. The DRMOs use local sales for items that do not have global appeal and either publish a catalog or hold an auction at the DRMO. Sealed bids are solicited for the catalog sales, and on-the-spot bids are made at the auctions. Items with commercial appeal, such as computers, furniture, and clothing are sold at retail stores at 40 DRMOs. Retail sales are made on a cash and carry basis.

Disposal Systems in the Private Sector

The disposal systems of private sector companies, particularly the commercial airlines, are much different than DOD's system, which is based on statutory requirements. For example, the airlines we interviewed place special emphasis on selling surplus property and create incentives for employees to maximize the return on sales. These companies expect to obtain reasonable proceeds from the surplus aircraft parts they sell and are less concerned than DOD with how quickly the property moves off the warehouse shelves. To maximize sales proceeds, staff are trained to understand aircraft parts terminology and the applications that exist for various parts. This training and experience make it more likely that highly marketable parts will be identified and marketed appropriately. Further, the staff often specialize in selling a specific category of part, such as engine parts, to promote a better understanding of the parts and the markets to which they sell.

In addition, progressive commercial companies provide employees with the resources to effectively sell surplus property. Marketing staff are provided a wide range of sales tools and techniques and are held accountable for the property they intend to sell. At one airline, sales personnel are responsible for the sale of the surplus property and are rated on how well they maximize sales proceeds. Figure 2 compares the differences between DOD's and the private sector's disposal processes.

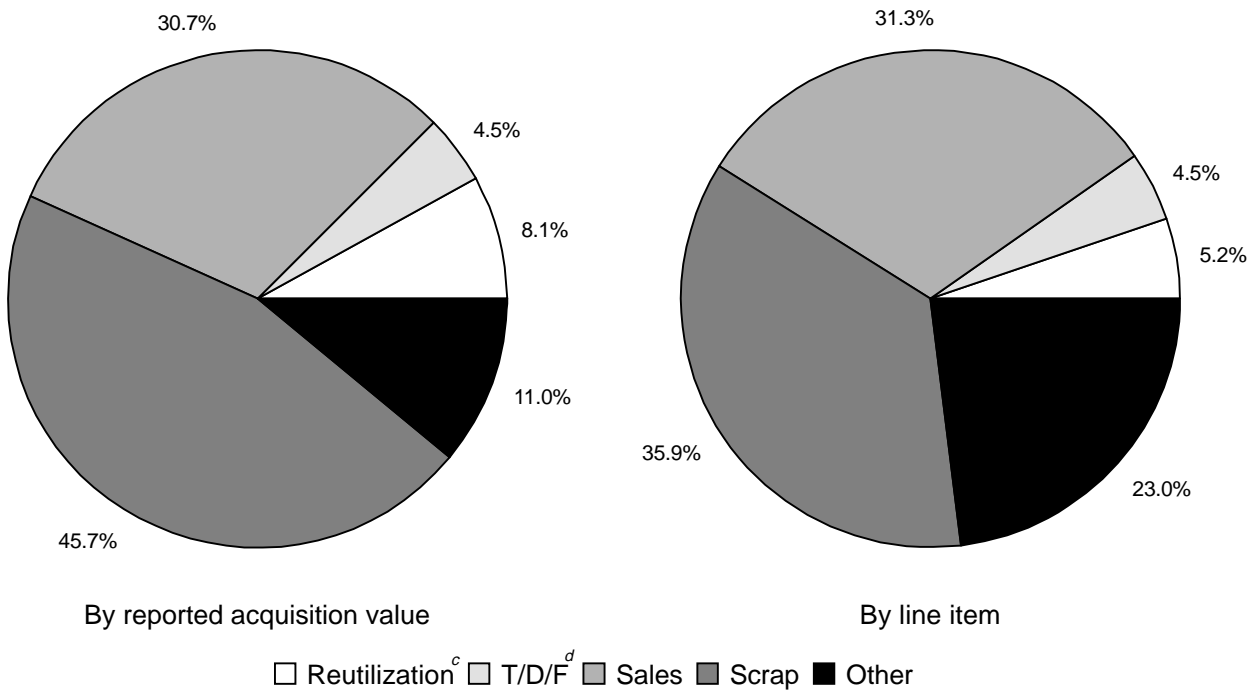
Figure 2: Comparison of DOD and Private Sector Disposal Processes

• DOD	• Private sector
<ul style="list-style-type: none">• Emphasizes moving items quickly and complying with laws• Handles huge quantities, types, and conditions of items• Cannot develop disposal expertise for 7 million active line items• Has rigid disposal system defined by laws and regulations; all items treated the same• Best items are taken through transfers and donations• Sells items that are usually not new	<ul style="list-style-type: none">• Emphasizes maximizing return• Handles few quantities, types, and conditions of items• Can develop disposal expertise for fewer items• Can tailor disposal strategy on an individual item basis• Best items are not taken through transfers and donations• Sells items that often were over bought or did not sell well (i.e., new items)

Large Majority of Items Disposed of Through Sales and Scrap

DOD's primary disposal objective is to maximize the reuse of surplus property within the military services, various levels of government, and authorized organizations before offering the property for sale to the general public. Despite this goal, DOD actually sells most of its surplus property to the general public either through sales efforts or as scrap, as shown in figures 3 and 4.

Figure 3: Average Dispositions, FY 1992-96



Note: Totals for the line item dispositions do not add due to rounding.

^cSome property declared excess by one activity within DOD is reutilized by other DOD activities.

^dIncludes personal property (1) transferred (2.1%) to other federal agencies or organizations given priority equal to the federal government, (2) donated (2.1%) to eligible organizations, and (3) sold (0.3%) to foreign military sales customers—the system through which government-to-government sales of military equipment are made.

Figure 4: Disposition by Reported Acquisition Value, FY 1992-96

Dollars in millions	FY 1992		FY 1993 ^f		FY 1994		FY 1995		FY 1996	
Reutilization	1,600	7%	1,770	5%	2,146	8%	2,295	9%	2,848	12%
Transfers	540	2%	532	2%	532	2%	575	2%	465	2%
Donations	502	2%	610	2%	648	2%	551	2%	592	2%
Sales	5,100	22%	9,100	26%	8,722	34%	9,189	38%	8,459	35%
FMS	99	<1%	18	<1%	84	<1%	42	<1%	133	1%
Scrap	9,882	43%	14,553	42%	13,557	53%	11,372	48%	11,099	47%
Other ^e	5,744	24%	7,878	23%	344	1%	318	1%	305	1%
Total	23,467	100%	34,461	100%	26,033	100%	24,342	100%	23,901	100%

^eAccording to DRMS personnel, the "other" category was significantly larger in fiscal years 1992 and 1993 than in subsequent years because it was used as a "catch all" category.

^fFiscal year 1993 disposals were larger than other years because of DOD base closures and drawdowns (force reductions).

DOD Has Efforts Underway to Improve Disposal Operations

DOD is seeking to improve its disposal process by using more commercial practices and making greater use of the private sector in disposing of property. While we have not done recent work in this area, our 1994 report stated that, while not always directly comparable to DOD, the commercial airlines' system for selling surplus aircraft parts reflects the profit incentive.¹ The airlines we interviewed expect to obtain reasonable rates of return on the surplus aircraft parts they sell. Officials from one airline told us they often receive as much as 50 percent of the manufacturer's list price (the price of the parts brand new) from the sale of their surplus aircraft parts.

¹Commercial Practices: Opportunities Exist to Enhance DOD's Sales of Surplus Aircraft Parts (GAO/NSIAD-94-189, Sept. 23, 1994).

Commercial companies use marketing techniques that substantially enhance the visibility and marketability of their parts, including (1) identifying highly marketable commercial-type parts, (2) selling the parts as Federal Aviation Administration certified, (3) arranging parts into sales groupings that meet buyer needs, and (4) actively marketing the parts to a full spectrum of civil aviation buyers. Even though it may not be practicable for DOD to duplicate commercial marketing techniques because of competing priorities, DOD could substantially increase its proceeds by adopting some basic marketing practices that have worked successfully in the private sector. Critical to the success of such practices, however, will be the establishment or realignment of incentives.

Compared with the private sector's rates of return for similar items, DRMS rates are low. As noted earlier, airline companies report receiving as much as 50 percent of the manufacturer's list price for aircraft parts. One reason for DRMS' lower rates of return is that many of the aircraft parts it disposes of have only military application, and those parts with commercial application are not certified by the Federal Aviation Administration, a requirement for commercial use. Another factor for the lower DRMS rate of return is that the best items are reutilized, transferred, or donated, leaving the least marketable items available for sale. The volume and types of items DRMS disposes of annually (about 4 million line items) also make it difficult for DRMS to develop expertise or tailor disposal strategies for individual items, as the private sector does. Moreover, the quantities, constant influx of items, and time limits on the various phases of the process drive DRMS' emphasis on moving items through the process quickly to make room for incoming items.

DOD Initiatives

In response to the recommendations made in our report and by others, DOD has developed several initiatives, changed some of its business processes, and adopted best practices to improve its property disposal operation. For example, DOD is employing or considering key initiatives, such as contracting with private auctioneering companies to conduct property sales, using the Internet to advertise available property, selling the property to private contractors that will dispose of it and share the proceeds with DOD, and allowing property located at the depots to remain there rather than shipping it to the DRMS to save labor and other costs. DRMS has also hired a financial advisor to assist in developing proposals for joint venture arrangements with the private sector.

In addition, DRMS plans on restructuring its organization, under a concept known as Enterprise Management, to operate and compete similar to a private enterprise by reorganizing into (1) a corporate and leadership unit, which will be staffed by government employees to handle inherently governmental functions, such as senior management and legal functions; (2) a utility function, which will handle the reutilization, transfer, and donation functions with the help of private firms, and (3) a marketplace function, which will contract with the private sector to handle sales and disposal of hazardous wastes. DOD activities will be able to choose whether they want to use DRMS' services for a fee or sell the property themselves.

DRMS' Activities Appear to Be Candidates for Outsourcing

Several recent reviews of DOD military forces, such as the Report of the Defense Science Board, the Commission on Roles and Missions, the Quadrennial Defense Review, and the Bottom-Up Review have recommended that competitive outsourcing be considered as an option to reducing costs, streamlining operations, and improving performance. The intent of competitive outsourcing is not to automatically give work to the private sector, but to determine, on a case-by-case basis, just how competitive the marketplace is and to take advantage of outsourcing if there are efficiencies to be gained through this means.

Legislative proposals have been introduced this year in Congress specifically related to the competitive procurement of services in connection with the disposal of surplus property at DRMS' locations. In particular, section 1402 of H.R. 1119 (the National Defense Authorization Act of 1998) requires that the Secretary of Defense establish procedures to conduct competitions among private sector sources and DRMS, and other interested federal agencies, for the performance of all such services at a particular site. Since DOD has identified DRMS as not an inherently governmental function, and, therefore, a candidate for outsourcing, we agreed with the aim of this legislation.²

In August 1995, we reported that DLA cited several impediments it believed would limit them from fully outsourcing the DRMS operation and would need to be carefully considered before an outsourcing decision was made. Some of the impediments related to the size and the scope of DRMS' operations; the lack of a demonstrated, comparable infrastructure in the commercial marketplace to manage the DOD disposal function; how a contractor would or should operate to ensure DRMS' mission is given the required level of emphasis; time and resource constraints with Office of

²1997 Defense Reform Bill: Observations on H.R. 1778 (GAO/T-NSIAD-97-187, June 17, 1997).

Management and Budget Circular A-76 procedures; and difficulties in preparing and administering contracts. Generally, the government and private sector officials we interviewed did not believe these impediments to be significant. DLA officials, while concerned with these impediments, indicated that DLA supports the outsourcing of functions or operations, on a case-by-case basis, where there is demonstrated competence in the private sector that will provide equal or better disposal services.

Mr. Chairman, this concludes our statement. We would be happy to answer any questions you or the members of the Subcommittee may have.

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