



Highlights of GAO-04-498, a report to the Chairman, Subcommittee on Defense, Committee on Appropriations, House of Representatives

Why GAO Did This Study

The Air Force depot maintenance activity group in-house operations generate about \$5 billion in annual revenue principally by repairing aircraft, missiles, engines, and other assets. In doing so, the group operates under the working capital fund concept, where customers are to be charged the anticipated costs of providing goods and services to them. The group's average price for in-house work almost doubled between fiscal years 2000 and 2004 from \$119.99 per hour to \$237.84 per hour. GAO was asked to determine (1) what factors were primarily responsible for the price increase, (2) if the prices charged recovered the reported actual costs of performing the work, and (3) if the Air Force has taken effective steps to improve efficiency and control the activity group's costs.

What GAO Recommends

GAO is making recommendations to the Air Force to (1) set prices so that the depot maintenance activity group recovers all estimated costs and (2) control the activity group's costs and improve the coordination and information on initiatives. GAO is also making a recommendation to the Department of Defense to reduce excess cash in the Air Force Working Capital Fund. GAO is also suggesting that the Congress consider taking action to reduce the amount of excess cash in the Air Force Working Capital Fund if DOD does not adequately reduce the cash balance. DOD concurred with all the recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-04-498.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Gregory D. Kutz at (202) 512-9505 or Kutzg@gao.gov or William M. Solis at (202) 512-8365.

AIR FORCE DEPOT MAINTENANCE

Improved Pricing and Cost Reduction Practices Needed

What GAO Found

GAO identified five primary factors that showed why the Air Force depot maintenance activity group's average price increased from \$119.99 per direct labor hour of work in fiscal year 2000 to \$237.84 per hour in fiscal year 2004. An increase in material costs accounted for about 67 percent of the total increase and was by far the most significant factor. The Air Force has identified some of the causes of the higher material costs such as aging aircraft, but has yet to complete an effective and comprehensive analysis of material cost increases. As a result, it (1) cannot quantify the extent to which individual causes contributed to higher costs and (2) does not know if it has identified all of the major causes.

GAO's analysis of the other four factors showed that (1) the increase in labor costs was due largely to events beyond the group's control, such as annual salary increases, (2) the increase in business operations costs was due partly to costs related to implementing a new accounting system, (3) a surcharge intended to recoup anticipated losses on work carried over from the previous fiscal year may have been unnecessary, and (4) a surcharge intended to generate additional cash in fiscal year 2004 for the Air Force Working Capital Fund was unnecessary. GAO's analysis showed that due in part to these surcharges (1) the Air Force Working Capital Fund, which includes the depot maintenance and several other activity groups, had a \$2.5 billion cash balance as of January 31, 2004 and (2) this balance was more than \$1.3 billion higher than the maximum level allowed by DOD policy. Either the Office of the Secretary of Defense or the Congress could use this unneeded cash to satisfy other requirements. DOD officials told us that they are exploring options on what to do with the excess cash.

GAO's analysis of the group's financial reports showed that prices charged customers were not set high enough to recover about \$1.1 billion of the group's reported costs for fiscal years 2000 through 2003. The activity group is required by DOD policy to set prices to recoup the cost of doing work. However, Air Force officials informed us that the prices were artificially constrained to help ensure that the group's customers would be able to get needed work done with the amount of funds provided to them through the budget process. The Air Force changed its sales price development philosophy to bring prices charged customers in fiscal year 2004 more in line with operating costs. In addition, the Air Force allowed out-of-cycle price increases in fiscal years 2002 and 2003 to alleviate projected losses.

Further, the Air Force Materiel Command has not been successful in its efforts to control costs. Although several promising initiatives are underway, the Command has not (1) developed a successful methodology for analyzing the reasons for the rapid material cost increase and (2) effectively utilized an established data repository for sharing cost-saving ideas among the three air logistics centers on process improvements and to demonstrate whether its cost savings initiatives have been successful.