

GAO

Report to the Chairman, Subcommittee on  
Readiness, Committee on Armed Services,  
House of Representatives

May 1992

# DEFENSE INVENTORY

## DOD Actions Needed to Ensure Benefits From Supply Depot Consolidation Efforts



146709

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**National Security and  
International Affairs Division**

B-247570

May 29, 1992

The Honorable Earl Hutto  
Chairman, Subcommittee on Readiness  
Committee on Armed Services  
House of Representatives

Dear Mr. Chairman:

In May 1991, you requested information on the Department of Defense's (DOD) supply depot consolidation program. In July 1991, the Defense Logistics Agency (DLA) estimated that consolidating the 30 military supply depots in the United States under a single manager would save a total of \$1.2 billion for fiscal years 1991 through 1997. In March 1990, DLA estimated that consolidating the five San Francisco Bay area depots as a prototype would save about \$128 million for fiscal years 1991 through 1995.

We agreed with your office to focus on the consolidation of supply depots in the San Francisco Bay area and to determine (1) the validity of DOD's estimated cost savings for the prototype consolidation and for all depots, (2) the validity of actual cost savings at the prototype depots, (3) the impact of consolidation on the depots' performance, and (4) whether impediments exist that could prevent DOD from fully achieving its projected benefits.

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**Results in Brief**

We believe consolidating supply depots under single agency management, if properly combined with other DOD initiatives, can result in more efficient and cost-effective depot operations. However, DOD's estimates of the savings that should result from consolidating the prototype depots and all of the depots are questionable. Both estimates were based on the assumption that the depot work load would remain constant; instead, the work load at the prototype depots we studied has declined. Also, the estimated savings for all depots was calculated using flawed data.

The actual savings that have been reported at the prototype depots for fiscal years 1990 and 1991 are due, in part, to the depots' decreased work load. The portion of savings attributable to the consolidation are not known because DLA has not separated savings due to consolidation from those due to decreased work load. Consequently, reported savings from consolidation are overstated.

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The prototype depots have generally met or exceeded their performance goals. DLA recognizes that its existing performance measurement system should be improved and is now developing a more useful system.

The size of DOD's inventory is a principal impediment to achieving the full benefit of depot consolidation. DOD's latest inventory report indicates that, as of September 30, 1991, \$21.3 billion of the total secondary item inventory of \$88.1 billion is excess to its requirements. Removing unneeded stock could lead to reducing the number and size of depots. The most significant improvements DOD could make to its depot system would be to (1) reduce its inventory and develop depot requirements based on reduced inventory levels and (2) accelerate the development of a much-needed standard automated distribution system.

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## Background

Supply depots receive, store, and issue supplies to support DOD's forces worldwide. The supply depots have a combined storage capacity of 705 million cubic feet, annually receive over 11 million items, and ship over 40 million items.

Before consolidation, each of the military services and DLA operated and managed their own depots and sometimes located them close to one another. For example, each of the military services and DLA operated supply depots within a 100-mile radius of San Francisco. In July 1989, DOD issued the Defense Management Report, an analysis of major actions needed to improve DOD management. One recommended action was that DOD supply depots be consolidated and transferred to DLA to reduce costs and significantly improve the use of existing capacity. On April 12, 1990, the Deputy Secretary of Defense approved the consolidation of DOD distribution functions under DLA. The Deputy Secretary ordered the implementation of a prototype supply depot system, comprised of the five depots in the Bay area,<sup>1</sup> as the first step. The five prototype depots were transferred to DLA between June 1990 and April 1991.

A plan for consolidating all DOD supply depots under DLA was approved in December 1990. According to the plan, depots would be grouped into three regions: Defense Distribution Region East, headquartered in New Cumberland, Pennsylvania; Defense Distribution Region Central, headquartered in Memphis, Tennessee; and Defense Distribution Region

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<sup>1</sup>The prototype installations include Oakland Naval Supply Center, Sharpe Army Depot, Tracy Defense Depot, Sacramento Army Depot, and Sacramento Air Logistics Center.

West (DDRW), which includes the prototype depots, headquartered in Tracy, California.

Appendix I details the three regions, supply depots, and the consolidation schedule.

### Estimated Consolidation Savings Inaccurate

In estimating savings from consolidating all of its supply depots, DOD used inconsistent and unvalidated cost data and assumed work load would not change. Similarly, the savings estimate for the prototype consolidation was based on an assumption that work load would remain constant; however, work load actually decreased. Consequently, the validity of both estimates is questionable.

### Total Consolidation Savings Were Based on Flawed Data

In estimating savings from the total consolidation, DLA assumed that work load would remain constant for fiscal years 1991 through 1997. As shown in table 1, the estimated \$1.2 billion in savings comprises \$837 million in reduced operating cost and \$381 million in avoided military construction cost. Military construction savings would accrue from planned construction projects that DLA deemed unnecessary under the consolidation.

**Table 1: Estimated Consolidation Savings for Fiscal Years 1991 Through 1997**

Dollars in millions			
Fiscal year	Operating cost	Military construction avoidance	Total
1991	\$13.4	\$22.3	\$35.7
1992	53.4	37.4	90.8
1993	114.6	136.8	251.4
1994	155.3	102.8	258.1
1995	167.0	81.8	248.8
1996	167.0	0	167.0
1997	167.0	0	167.0
<b>Total</b>	<b>\$837.7</b>	<b>\$381.1</b>	<b>\$1,218.8</b>

The estimated \$837 million in reduced operating cost is based on anticipated savings of \$167 million every year that DLA operates all the existing depots. For fiscal years 1991 through 1994, DLA prorated the anticipated savings based on the number of depots transferred to DLA in each year. The \$167 million includes (1) \$142 million in estimated

operational savings from overhead consolidation and operational efficiencies from single agency management and (2) \$25 million in projected savings from using a standard automated system. According to a DLA official, the estimate was based on an October 1990 DLA report<sup>2</sup> that assumed no decrease in work load and, as explained below, used flawed unit cost data.

The unit cost system, which DOD began using for supply operations during fiscal year 1989, calculates a cost per unit based on a depot's primary output—receipt and issue of inventory items. To estimate annual operational savings, DLA assumed it would operate all the supply depots at the same unit cost that it used in operating its depots in fiscal year 1989. However, according to DOD officials, the military services' and DLA's unit costs are not comparable because of reporting disparities among the military services and DLA as well as different definitions of unit cost data categories.

The DOD Comptroller, the military departments, DLA, and the Defense Manpower Data Center are currently working together to validate the data collection process, ensure that calculations are correct, and reconcile the differences among unit cost reports. According to a DOD Comptroller official, fiscal years 1990 and 1991 cost data will be recalculated based on this validation effort. However, fiscal year 1989 cost data will not be recalculated because it is outdated and, according to a DOD Comptroller official, of little use. In addition, a DLA official stated that DLA's next consolidation savings estimate will not be based on unit cost because of the data's many problems. The official noted that a new methodology had not yet been determined.

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## Prototype Savings Distorted by Work Load Decline

In March 1990, DLA estimated that total savings from consolidating the five prototype depots would be about \$128 million for fiscal years 1991 through 1995. Of the total, \$98.7 million was salary savings based on an estimated reduction of 807 employees. In estimating employee reductions, DLA assumed that the work load would remain stable and that it could raise the productivity of the four military services' depots to match DLA's depot rate of 2,112 receipts and issues annually per employee.

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<sup>2</sup>DOD Supply Depot Consolidation: Preliminary Estimate of Savings, (DLA-91-P00189).

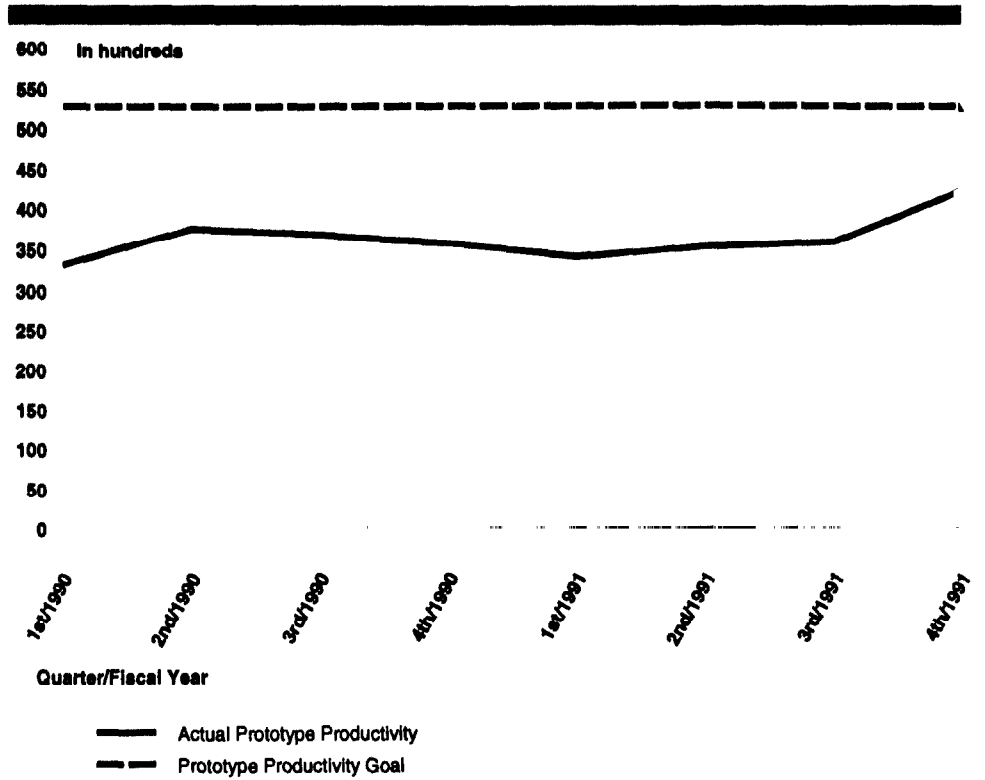
In computing the actual savings for the prototype, DLA used a different starting point than in its estimate and included personnel attrition that occurred in fiscal year 1990. On this basis, for fiscal years 1990 and 1991, DDRW reported actual prototype savings of \$25.5 million. About 98 percent (\$24.8 million) of the \$25.5 million savings resulted from personnel attrition, while the remaining 2 percent included savings in equipment purchases and administrative expenses.

According to DLA, attrition accounted for 721 employees during fiscal years 1990 and 1991, and as a result, the total on-board personnel were reduced from 5,074 to 4,353. During this period, DLA data shows that DDRW's annual work load decreased about 3 percent—from 7 million to 6.8 million receipts and issues. The decline would have been greater except one quarter's work load was significantly increased because of material returned from the Gulf War. During the same period, the prototype depots' productivity rate increased but did not reach DLA's productivity rate goal.

DLA did not separate personnel reductions that resulted from work load reductions from savings that resulted from consolidation. DLA officials believe that attrition would have been lower if DLA did not have single management of the prototype depot resources. However, without identifying savings resulting from consolidation, prototype savings cannot be accurately computed. According to a DLA official, DDRW is trying to identify savings related to work load reductions.

Figure 1 shows DLA's productivity rate goal compared to the actual prototype rate.

**Figure 1: Prototype Productivity Rate:  
Work Load Per Employee**



Source: DDRW data.

In 1991, DDRW reported that the prototype depots' total consolidation costs, exclusive of automated system development,<sup>3</sup> would be about \$6.7 million through fiscal year 1991. Because the costs were reconstructed, DDRW officials cautioned that they may not have captured all consolidation costs; however, DLA reports net prototype savings to be about \$19 million through fiscal year 1991.

<sup>3</sup>As of September 30, 1991, about \$20 million was spent on development and installation of the computer system at two of the five prototype supply depots. Officials estimated it would cost an additional \$15 million to complete installation at the five depots and millions more if the system were installed in the remaining depots nationwide.



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## DLA Generally Met Performance Goals During Consolidation

In a May 1990 report, the DOD Inspector General sharply criticized the Department's Military Supply and Transportation Evaluation Procedures system. The report called the system's data inconsistent, inaccurate, incomplete, and untimely. It stated that as a result of these deficiencies, the military departments had developed their own unique systems for collecting data and evaluating supply and transportation procedures.

Until DLA develops and installs a standard automated distribution system, it must track performance and manage inventory using different automated systems at each depot. As a result, depots can only be assessed individually.

After consolidation, DLA monitored each depot's performance using the currently installed systems and standards. DLA assessed performance using primary indicators such as receipt processing, shipping effectiveness, material denials, and location accuracy. Overall, DLA found that performance was maintained or improved after the consolidation.

DLA implemented actions to improve operational efficiencies at the depots and, in August 1991, initiated actions to develop standard performance definitions and measures. DLA officials and military service representatives identified the need to develop (1) indicators to measure the effects of consolidation on mission readiness and (2) criteria for new performance measurement standards.

Until DLA implements a new system to compile work load and performance information, the military services and DLA representatives are addressing performance issues through memorandums of agreement. According to these officials, the agreements include information on how performance requirements will be met and verified. The agreements indicate that DLA will maintain or improve performance but do not explain how this will be done. Nonetheless, representatives from all the services were satisfied with the agreements and had no problems with DLA's performance since the consolidation.

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## Impediments Can Affect DOD's Ability to Achieve Consolidation's Full Benefits

Two major impediments must be addressed by DOD to achieve the full benefits of supply depot consolidation. First, the large amount of inactive inventory stored in the depots must be reduced and be reflected in DOD's inventory positioning plans. Second, DLA must implement a standardized automated system for the supply depot distribution function.

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**Stocking Unneeded Inventory  
Reduces Consolidation  
Savings**

To increase efficiency and storage space, DLA developed a conceptual stock positioning plan. The plan calls for a distribution system comprised of primary warehousing sites from which the fastest moving stock will be issued; specialized sites which will handle items like hazardous materials; and other sites which will house slow-moving and dormant stock. DLA anticipates significant savings by consolidating stock at primary sites, resulting in larger shipping units and reduced packaging and transportation costs. It is preparing an economic analysis for determining stock location criteria and expects to complete the analysis by mid-year 1992. However, this analysis will not address the potential impact of inventory reduction on the required number and location of supply depots or the impact that reduced demand caused by military force structure reductions will have on stock attrition.

The 1991 DOD Supply System Inventory Report indicated that at the end of fiscal year 1991, secondary items worth \$21.3 billion were excess to requirements. Since March 1990, we have issued reports on such DOD inventory management issues as growth in inventories, the amount of unrequired requirements determination, and excess on-order material.<sup>4</sup> Our work indicates that the amount of on-hand inventory that DOD reports as required is more than is necessary or prudent. Consequently, we believe the \$21.3 billion in unrequired inventory reported by DOD is significantly understated.

As DLA consolidates the high demand inventory items in its three primary regional distribution centers, the remaining military supply depots will be left with increasing percentages of inactive secondary item inventory, such as aircraft, ship, and vehicle parts; electronic components; and general supplies that are broken, outmoded, or retained only for contingency purposes. Retaining this material will complicate and increase the cost of DLA's regional stock positioning plans.

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<sup>4</sup>Defense Inventory: Top Management Attention is Crucial, (GAO/NSIAD-90-145, Mar. 26, 1990).

Defense Inventory: Shortcomings in Requirements Determination Processes, (GAO/NSIAD-91-176, May 10, 1991).

## Standard Automated System Needed to Fully Achieve Consolidation's Benefits

DLA officials believe a standard automated distribution system is needed to give managers visibility over depot resources and performance. This visibility would enhance DLA's ability to make optimum use of depot resources. A standard automated system would optimize opportunities for streamlining operations and consolidating depot functions and would eliminate the costs associated with the design, development, and maintenance of separate automated systems. The Defense Distribution System, originally conceived as the standard system for the five prototype depots, is operational at only three depots because of technical difficulties.<sup>5</sup> Current plans are that it will be used only where currently installed. DOD has decided to use existing automated distribution systems at all other depots until an acceptable standard system is ready. This means that the 30 supply depots will be using 11 different automated distribution systems. In February 1992, DOD selected the Army's Area Oriented Depot System as the standard system for supply depots, but the system is not expected to be operational at all sites for several years. However, the Army system may experience the same system integration problems as the Defense Distribution System.

## Recommendations

To achieve the full benefits of consolidation, we recommend that the Secretary of Defense (1) increase DOD's efforts to reduce the amount of stock in the supply depots and (2) accelerate efforts to develop a standard distribution system for the supply depots.

We also recommend that the Secretary of Defense instruct the Director, Defense Logistics Agency, to develop a supply depot organization and stock repositioning plan based on reduced DOD inventory.

## Agency Comments

In commenting on a draft of this report, DOD expressed concern that the report's message regarding savings from consolidation was overly negative and that we had confused DOD's Inventory Reduction Plan with its supply depot consolidation goals. Department officials disagreed with our recommendation to accelerate stock reduction in the depots and development of a standard distribution system for the depots. However, they agreed that DLA should develop a supply depot organization and stock positioning plan based on reduced inventory. We still believe that savings attributable to consolidation cannot be clearly identified and that inventory

<sup>5</sup>Defense ADP: Lessons Learned From Development of Defense Distribution System, (GAO/IMTEC-92-25, Mar. 20, 1992).

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reduction is essential for significant improvement of DOD's depot system. We believe our recommendation to the Secretary of Defense is needed since inventory reduction in the depots cannot be achieved independently by DLA and will require actions by each of DOD's inventory managers. However, we agree that, if properly combined with other DOD initiatives, consolidation can result in a more efficient and cost-effective depot system.

We have considered DOD's comments and have incorporated their concerns where appropriate in our final report. DOD's comments and our response are included as appendix III.

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Appendix II describes our scope and methodology.

Please contact me at (202) 275-8412 if you or your staff have any questions concerning this report. Major contributors are listed in appendix IV.

Sincerely yours,



Donna M. Heivilin  
Director, Logistics Issues



# DLA Regions and Consolidation Schedule

<b>Defense Distribution Region West</b>	<b>Date of consolidation</b>
Defense Depot, Tracy, California	June 1990
Sharpe Army Depot, Lathrop, California	June 1990
Naval Supply Center, Oakland, California	June 1990
Sacramento Army Depot, California	April 1991
Sacramento Air Logistics Center, California	April 1991
Air Logistics Center, Hill Air Force Base, Utah	October 1991
Defense Depot, Ogden, Utah	October 1991
Naval Supply Center, Puget Sound, Washington	March 1992
Naval Supply Center, San Diego, California	March 1992
Tooele Army Depot, Utah	March 1992
Marine Corps Logistics Support Base, Barstow, California	March 1992
<b>Defense Distribution Region Central</b>	
Naval Supply Center, Jacksonville, Florida	April 1991
Air Logistics Center, Warner-Robins Air Force Base, Georgia	March 1992
Marine Corps Logistics Base, Albany, Georgia	March 1992
Defense Depot, Memphis, Tennessee	August 1991
Red River Army Depot, Texarkana, Texas	October 1991
Naval Air Station, Pensacola, Florida	March 1992
Air Logistics Center, San Antonio, Texas	March 1992
Air Logistics Center, Oklahoma City, Oklahoma	March 1992
Corpus Christi Army Depot, Texas	March 1992
Anniston Army Depot, Alabama	March 1992
<b>Defense Distribution Region East</b>	
Defense Depot, Columbus, Ohio	March 1992
New Cumberland Army Depot, Pennsylvania	April 1991
Defense Depot, Mechanicsburg, Pennsylvania	April 1991
Defense Depot, Richmond, Virginia	August 1991
Marine Corps Air Station, Cherry Point, North Carolina	February 1992
Naval Supply Center, Charleston, South Carolina	March 1992
Letterkenny Army Depot, Pennsylvania	March 1992
Tobyhanna Army Depot, Pennsylvania	March 1992
Naval Supply Center, Norfolk, Virginia	March 1992

# Scope and Methodology

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We conducted our work at the Defense Logistics Agency's headquarters in Alexandria, Virginia, and the Defense Distribution Region West, Lathrop, California; the DOD Comptroller; the Air Force's Supply and Fuel Policy Division; and the Army's Supply Policy Division, Office of the Deputy of Staff for Logistics, Washington, D.C.; and the Naval Supply Systems Command, Alexandria, Virginia.

To examine consolidation savings and savings estimates, we reviewed DLA and DOD documents describing the savings estimates and reported savings. We also reviewed DLA documents describing consolidation costs. We interviewed DOD Comptroller staff to determine what information they collected and how they used and analyzed data, but we did not independently verify the data. In addition, we interviewed DLA and DOD Comptroller staff to determine how they identified savings attributable to consolidation.

To address performance of depots after consolidation, we interviewed DLA officials and contacted military service representatives to determine if they were satisfied with DLA's performance. We obtained pre- and post-consolidation performance data from DLA to determine whether any performance degradations had occurred. We collected performance information showing the prototype's work load, performance goals, performance measures, and results. However, complete work load and performance indicator information was unavailable for fiscal years 1989 through 1991 at each site. We did not assess the validity of systems used by DLA to accumulate the data or the standards applied to depot performance.

To identify impediments to further consolidation, we interviewed DLA staff and military service representatives. We collected information on DLA and DOD efforts to develop a standard automated distribution system but did not review the automation initiatives in detail. Additionally, we met with DOD's independent evaluator, the Logistics Management Institute, to identify opportunities for exchanging of information.

We conducted our review from January through November 1991 in accordance with generally accepted government auditing standards.

# Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



PRODUCTION AND  
LOGISTICS

(L/SD)

## ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, DC 20301-8000

25 MAR 1992

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: DoD Actions Needed to Ensure Benefits from Supply Depot Consolidation Efforts," dated March 9, 1992 (GAO Code 398063) OSD Case 8986.

The Department is concerned that the report message is overly negative, particularly in view of the information the Department has provided the GAO evaluators during the course of the audit. Nowhere does the draft report indicate that the Department decision to consolidate supply depot management is a good business decision, nor does it indicate that the savings potential is great. Instead, the GAO focused only on one aspect--the manner in which the savings projections were calculated and the difficulty that both the Department and the GAO have had in identifying those savings due solely to consolidation. The GAO also confuses the supply depot consolidation initiative with the DoD Inventory Reduction Plan. While the initiatives are complementary, each stands on its own merits and the projected savings of each is achievable independently.

The supply depot consolidation initiative is a major change in the way the Department conducts its distribution business. It embodies a number of consolidation concepts, none of which should be underrated. First, it is the consolidation of management under a single manager. Strategic planning for the composition, structure, and investment in the DoD Distribution System will be made from a DoD-wide perspective by the Defense Logistics Agency. The individual DoD Component distribution management and overhead structures are being eliminated. Secondly, the consolidation allows separate but proximate supply depot sites to be managed and operated as though they were a single site, promoting optimum utilization of resources. Lastly, consolidation reduces stockage duplication, which reduces supply depot operations and transportation costs.



**Appendix III  
Comments From the Department of Defense**

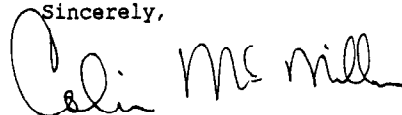
The Department Inventory Reduction Plan, on the other hand, will reduce significantly the size of the secondary item inventory. That comprehensive plan is purging the system of materiel for which there is no longer a requirement, and ensuring that future purchases and stockage of materiel satisfy future requirements with the least possible investment. The Department will reduce the inventory of secondary items to \$55 billion by FY 1997 in constant 1990 dollars. While the large reduction will result in a reduced storage space requirement, it is premature to identify site closures.

Approximately 75 percent of the DoD warehouses were built in the 1940s or earlier. The older warehouses are continuing to deteriorate and to require constant and sizable maintenance/repair investments. A great many have low stacking heights, low floor load capacities, and many support pillars, all of which limit the application of modern efficient storage techniques, storage aids and equipment. Those are the warehouses that will be eliminated from the system first, as storage requirements decline. Until the full impact of the Inventory Reduction Plan, force reductions, and supply depot consolidations is known, premature closure of warehouses or entire facilities would be unwise. Only the most essential Military Construction projects will be requested.

In summary, through the supply depot consolidation initiative, the Department has postured itself to evolve to an efficient DoD-wide distribution system that is capable of adjusting rapidly to changing demands and requirements. While it is difficult to quantify precisely those savings solely attributable to consolidations at specific depots, the fact remains that service to the customer has been maintained and supply system costs have been reduced. The projected \$1.2 billion savings goal was predicated on savings that will be achieved through management and distribution efficiencies once consolidation of all the depots is completed, not on a site by site basis.

The detailed DoD comments on the draft report findings and recommendations are provided in the enclosure. Suggested technical corrections were provided separately to your staff at a meeting held March 18, 1992. The DoD appreciates the opportunity to comment on the GAO draft report.

Sincerely,



Enclosure

Appendix III  
Comments From the Department of Defense

GAO DRAFT REPORT - DATED MARCH 9, 1992  
(GAO CODE 398063) OSD CASE 8986

"DEFENSE INVENTORY: DOD ACTIONS NEEDED TO ENSURE BENEFITS  
FROM SUPPLY DEPOT CONSOLIDATION EFFORTS"

DEPARTMENT OF DEFENSE COMMENTS

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FINDINGS

FINDING A: The GAO concluded that the DoD estimates of the savings that should result from consolidating the prototype depots and all of the depots are questionable. The GAO reported that, for the period FY 1990 through FY 1997, the DoD estimated \$1.2 billion in savings for the total consolidation initiative. The GAO noted that the \$1.2 billion is comprised of \$837 million in reduced operating costs and \$381 million in avoided military construction costs. The GAO further noted that, in March of 1990, the Defense Logistics Agency estimated that the total savings from consolidating the five prototype depots would be about \$128 million for FY 1991 through FY 1995.

The GAO concluded that both savings estimates are questionable because the Defense Logistics Agency used inconsistent and unvalidated cost data and assumed workload would remain constant for FY 1991 through FY 1997. The GAO pointed out that the Defense Logistics Agency assumed it would operate all of the supply depots at the same unit cost it used in operating its depots in FY 1989. The GAO asserted, however, that the Military Services and Defense Logistics Agency unit costs are not comparable because of reporting disparities among the Services and the Agency, as well as different definitions of unit cost categories. The GAO observed that, although the Agency assumed that the workload would remain stable and that it could raise the productivity of the Military Service depots to match the Agency depot rate of 2,112 receipts and issues annually per employee, the workload actually decreased. (p. 2, pp. 5-9/GAO Draft Report)

DOD RESPONSE: Nonconcur. The Department does not agree that the DoD estimates of the savings, which are expected to result from consolidating the prototype depots and all of the depots, were unrealistic. The DoD objective was to determine if the order of magnitude of the potential savings justified this significant change in the way the Department conducted the distribution business. The Department is confident that the original projected savings will be met or exceeded. That confidence is supported by actual experience. The Department projected \$126.5 million in cumulative savings through FY 1992--and the recorded actual savings just through January 1992 are \$154.6 million.

See comment 1.

Now on p. 3.

In early 1990, when the savings were projected, the assumption of a constant workload was appropriate. The receipt and issue workload in FY 1988 was 46.3 million lines, and in FY 1989 it was 46.9 million lines. Even after the consolidation, the aggregate workload remained relatively constant, going from 45.1 million lines in FY 1990, to 45 million lines in FY 1991. While there were workload reductions at some specific depots, the savings estimates are based on aggregate workload, which has decreased very little.

Additionally, at the time the projections were made, the "Unit Cost" initiative was in its formative stages; therefore, it was not the basis of the estimate. The assumption was made that consolidation of the supply depots could increase productivity to the point that the average employee could process 2,112 receipts and issues annually. That was an average rate, which assumed that the processing productivity of all items could be improved. It did not, however, assume that personnel at all depots could process all items at a rate of 2,112. The physical characteristics of the items handled at the depots vary considerably from site to site. Consequently, the processing capability and costs also will vary considerably.

FINDING B: The GAO concluded that the actual savings reported at the prototype depots for FYs 1990 and 1991 are due, in part, to the decreased workload at those depots. The GAO determined that the amount attributable to the consolidation is not known because the Defense Logistics Agency has not separated savings due to consolidation from those due to decreased workload. The GAO, therefore, asserted that the reported savings are overstated. (p. 2, p. 9/GAO Draft Report)

DOD RESPONSE: Partially concur. The Department agrees that it is difficult to segregate savings so that those solely identifiable to consolidation can be measured accurately. The Defense Logistics Agency has, however, identified a total of \$154.6 million in savings through January 1992. Fifty-five percent of the savings to date are from military construction and equipment cost avoidances. The primary source of the total projected \$1.2 billion supply depot consolidation savings are from (1) the consolidation of management and overhead, (2) the consolidation of proximate supply depot sites, and (3) the consolidation of item stockage—all of which facilitate supply depot operations and transportation efficiencies.

If the GAO is proposing that all savings attributable to workload reductions should be discounted, the Department does not agree. While the workload did decline at some depots, the aggregate workload has declined only slightly. The GAO approach also assumes that each of the previous managers of the respective depots would have reduced personnel equal to the workload

Now on p. 4.

reductions. The argument could be made that the previous managers would also have cancelled the same Military Construction and equipment purchases that the Defense Logistics Agency cancelled, and instituted the same efficiencies--such as the elimination of a Consolidation Containerization Point. That is clearly not the case.

FINDING C: The GAO concluded that the DoD has reported that \$29 billion of the total secondary item inventory of \$101.9 billion is unneeded. The GAO reported that, since March 1990, it had issued reports on DoD inventory management issues (OSD Cases 8271 and 8645)--which indicated that the amount of on-hand inventory the DoD reports as required is more than is necessary or prudent. The GAO asserted, therefore, that in its view, the \$29 billion in unrequired inventory reported by the DoD is significantly understated. (p. 3, pp. 14-15/GAO Draft Report)

Now on p. 8.

DOD RESPONSE: Nonconcur. The Department does not agree that it has reported \$29 billion of the total secondary item inventory of \$101.9 billion is unneeded. That is a gross overstatement. The only portion of the \$29 billion that can be classified as unneeded is the \$8.1 billion identified for Reutilization/Disposal. The remaining portion of the \$29 billion is being retained for future requirements and for contingencies. The recent DoD experience during DESERT SHIELD/DESERT STORM was that a significant amount of such materiel was used.

FINDING D: The GAO concluded that the most significant improvement the Defense Logistics Agency could make would be to reduce its inventory by disposing of unneeded stock and by the acceleration of a much-needed standard automated distribution system. The GAO noted that, as the Defense Logistics Agency consolidates the high demand inventory items at its three regional distribution centers, the remaining military supply depots will be left with increasing percentages of inactive inventory that is broken, outmoded, or retained for contingency purposes. The GAO asserted that retaining such materiel will complicate and increase the cost of the regional stock positioning plans. The GAO further asserted that removing unneeded stock could lead to reducing the number and size of the depots. (p. 3, pp. 14-16/GAO Draft Report)

Now on p. 8.

DOD RESPONSE: Partially concur. The Department agrees that significant reductions in the inventory will occur under the DoD Inventory Reduction Plan. The Defense Management Report initiatives, coupled with the extraordinary worldwide political changes, provide the opportunity to make substantial reductions in the inventory. The DoD Inventory Reduction Plan will reduce the current dollar value of secondary items to \$55 billion by FY 1997 (in constant 1990 dollars). That is a DoD-wide Inventory

Reduction Plan for which the DoD Inventory Control Points have primary responsibility. However, the Defense Logistics Agency, as the single manager of the distribution system, does not have the ability or the authority to reduce the inventory. That responsibility and authority rest with the Service/Agency Inventory Control Points. Additionally, while the Department agrees that the inventory reduction "could" result in a reduced size and number of depots, such forecasts are premature.

The Inventory Reduction Plan will reduce the dollar value of secondary items by 46 percent from the 1990 baseline year. This will, in turn, reduce warehouse space requirements. However, the reduction in space requirements will not be proportionate to the Inventory Reduction Plan dollar value reductions. Required materiel that is currently in outside storage will be moved into covered space, and DoD will cease to use the older, less efficient warehouses.

Until the full impacts of the Inventory Reduction Plan, force reductions, and supply depot consolidations are known, premature closure of warehouses or entire facilities would be unwise. The Defense Logistics Agency, which as of March 16, 1992, became the manager of all the supply depots, is in a position to begin a DoD assessment of future storage space requirements. That assessment is underway. Any closure considerations will be handled in accordance with Public Law 101-510 as amended, through the Base Closure Commission and according to the schedule prescribed in the statute.

The Department agrees that development and deployment of the Distribution Standard System will provide complementary efficiencies to the depot management consolidation initiative. The Department is developing a detailed cost and deployment schedule for the Distribution Standard System. That detailed planning document will be completed in September 1992.

**FINDING E: The GAO concluded that the Defense Logistics Agency generally met performance goals during consolidation.** The GAO found that the prototype depots have generally met or exceeded the performance goals. The GAO noted that, after consolidation, Defense Logistics Agency monitored the performance of each depot, using the currently installed systems and standards. The GAO observed that the Defense Logistics Agency assessed performance using such indicators as (1) receipt processing, (2) shipping effectiveness, (3) materiel denials, and (4) location accuracy. The GAO found that there are some differences between the performance measures used by the Services and the Defense Logistics Agency. They reported that the Defense Logistics Agency and the Military Services currently are working to develop standard performance definitions and measures. The GAO further reported that representatives of all the Services were satisfied

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with the performance measurement agreements and had no problems with the performance of the Defense Logistics Agency since the consolidation. The GAO pointed out that until the Agency implements a new system to compile workload and performance information, the Military Services and the Defense Logistics Agency are addressing performance issues through memorandums of agreement. (p. 2, pp. 11-13/GAO Draft Report)

**DOD RESPONSE:** Concur. The Department agrees that performance has generally been maintained or improved, and that the Military Services have not had a problem with performance since the consolidation. The Department also agrees that there are some inconsistencies in the way performance is measured. Those discrepancies currently are being reconciled. Additionally, some standardization of definitions and performance measurement can be effected prior to the implementation of the Distribution Standard System.

**FINDING F:** The GAO concluded that the full benefits of the supply depot consolidation cannot be achieved until (1) the DoD aggressively reduces inactive inventory stored in the depots and reflects the reductions in its stock repositioning plans and (2) the Defense Logistics Agency places all supply depots under its management and implements a standardized automated system for the supply depot distribution function. The GAO found that the Defense Logistics Agency developed a conceptual stock positioning plan calling for a distribution system comprised of warehousing sites from which the fastest moving stock will be issued, sites to handle special items, such as hazardous materials, and sites which will house the stock where very few issues are expected. The GAO further found that the Defense Logistics Agency is preparing an economic analysis for determining stock location criteria--which it expects to complete by mid-year 1992. The GAO pointed out, however, that the analysis will not address the potential impact of inventory reduction on the required number and location of supply depots or the impact that reduced demand caused by military force structure reductions will have on stock attrition. The GAO asserted that stocking unneeded inventory reduces potential consolidation savings.

The GAO reported it is the view of the Defense Logistics Agency that a standard automated distribution system is needed to give managers visibility over depot resources and performance. The GAO agreed that such visibility would enhance the ability of the Agency to make optimum use of depot resources. The GAO further pointed out, however, that the Defense Distribution System, which was originally conceived as the standard system for the five prototype depots, is operational at only three depots because of technical difficulties--and current plans are that it will be used only where currently installed. The GAO noted that means

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the 30 supply depots will be using 11 different automated distribution systems. The GAO concluded that, inasmuch as the Defense Logistics Agency standard automated distribution system is being developed as part of the Corporate Information Management initiative, it is not expected to be operational for several years. (pp. 13-16/GAO Draft Report)

**DOD RESPONSE:** Partially concur. The Department agrees that a small portion of the projected supply depot consolidation savings, \$25 million per year, is associated with the implementation of the Distribution Standard System. The Department does not, however, agree that the full benefits of the supply depot consolidation initiative are dependent upon the Department's Inventory Reduction Plan. Those two Defense Management Report initiatives are complementary; however, each stands on its own merits and the projected saving of each is achievable independently. The Inventory Reduction Plan will reduce the dollar value of secondary items by 46 percent between FY 1990 and 1997, and the supply depot consolidation initiative will meet or exceed the projected \$1.2 billion savings goal.

Recognizing that the full benefits of consolidation could not be achieved until all the supply depots are under single management, on February 27, 1992, the Assistant Secretary of Defense (Production and Logistics) announced the decision to complete the consolidation effective March 16, 1992. Additionally, in January 1992, the Executive Agent for Distribution completed the evaluation of the candidate automatic data processing systems. The candidate systems were evaluated against technical, functional, cost, and schedule criteria to determine the system that best supports the DoD distribution mission requirements and the supply depot consolidation initiative. The Executive Agent for the distribution system development has certified that the selected system, Area-Oriented Depot/Modernization, is developed, operational, and fully meets the requirement of Section 313 of the National Defense Authorization Act for Fiscal Years 1992 and 1993. A Major Automated Information System Review Council in-process review will be conducted during Calendar Year 1992, to review the recommended Distribution Standard System. The in-process review will include an examination of the functional, technical, and economic merits of the recommended standard distribution system. Planning is now in process to lay out the deployment and cost schedule to deploy the Distribution Standard System throughout the Department.

While the Department agrees that inventory reductions will provide the opportunity for additional savings in the distribution system, the primary supply depot consolidation savings are from (1) the consolidation of management and overhead, (2) consolidation of proximate supply depot sites, and

(3) consolidation of item stockage--all of which facilitate supply depot operations and transportation efficiencies.

\* \* \* \* \*

RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense accelerate (1) stock reduction in the supply depots and (2) efforts to develop a standard distribution system for the supply depots. (p. 17/GAO Draft Report)

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DOD RESPONSE: Nonconcur. The Department does not agree that the stock reductions under the Inventory Reduction Plan and the development/deployment of the Distribution Standard System for supply depots should be accelerated. If the Department considered it possible and a reasonable objective, it would have done so--just as it accelerated the supply depot consolidation schedule. The Department is developing a detailed cost and deployment schedule for the Distribution Standard System. That detailed planning document will be completed in September 1992.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense instruct the Director, Defense Logistics Agency, to develop a supply depot organization and stock repositioning plan based on reduced DoD inventory. (p. 17/GAO Draft Report)

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DOD RESPONSE: Partially concur. The Department agrees that such actions are necessary; in fact, they are already underway. The concept plan for consolidation of supply depots provides the overall stock positioning framework from which the Defense Logistics Agency is developing detailed stock positioning plans, which will be completed by mid-1992. It is pointed out, however, that while stock positioning decisions are negotiated between the Inventory Control Points and supply depot management, the primary responsibility for stockage/stock positioning decisions rests with the Inventory Control Point.

In addition to the ongoing implementation to consolidate all the remaining supply depots immediately, the Defense Logistics Agency has a number of additional planning initiatives underway, as follows:

- efficiency reviews designed to seek consolidation savings more aggressively through more efficient processes;
- development of future space requirements considering the combined impacts of the Inventory Reduction Plan, force reductions, and new distribution practices; and
- deployment of a Distribution Standard System to include standard workload and performance measurement.



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The following are GAO's comments on the Department of Defense's letter dated March 25, 1992.

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**GAO Comment**

1. We stand by our observation that the methodology for estimating savings from consolidation is questionable since there is no way of isolating savings attributable to other factors that occur simultaneously. The \$154.6 million that DOD cites as recorded actual savings from consolidation through January 1992 is a total of all personnel attrition and other cost reductions in the supply depots since fiscal year 1990. Some of these cost reductions would have occurred regardless of consolidation.

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