



## Testimony

Before the Subcommittee on Military Readiness,  
Committee on Armed Services, House of Representatives

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# DEFENSE INVENTORY

## Continuing Challenges in Managing Inventories and Avoiding Adverse Operational Effects

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Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to testify today on the Department of Defense's (DOD) logistics capabilities and shortfalls. You asked us to look at inventory issues as they relate to DOD's operations and readiness. My testimony today will focus on the results of our recent work pertaining to (1) the status of DOD's secondary inventory,<sup>1</sup> (2) difficulties one military service continues to have in obtaining repair parts to keep its combat aircraft mission capable, (3) the adequacy of DOD's controls over inventory items in transit, (4) implementation of DOD's efforts to have greater visibility over its logistical assets through its Total Asset Visibility Program, and (5) the continuing need to apply best private sector management practices to Defense inventory management.

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## Results in Brief

Our work continues to show weaknesses in DOD's inventory management practices that are detrimental to the economy and efficiency of operations and cause operational problems for DOD. DOD continues to maintain large inventories that may be as much as 60 percent in excess of current needs. Although DOD has made progress in reducing its inventories, further reductions are needed. Additionally, other action is needed to avoid unnecessary new purchases. DOD spends approximately \$13 billion each year on new inventory items. While new purchases may be initiated to meet justified requirements, those requirements frequently change after items are ordered, but affected orders are not always canceled. We found that as of September 30, 1997, DOD did not need about \$1.5 billion, or 18 percent, of the inventory it had ordered to meet current requirements. Not canceling these orders further exacerbates DOD's excess inventory condition and also prohibits spending on other priority needs.

Despite having inventory items in excess of its current needs, DOD can also be faced with situations of inventory shortages and other related supply problems that can adversely affect operational requirements. In our review of Air Force supply management we found that shortages in aircraft spare parts caused a degradation in mission capable rates for key aircraft, including the B-1B, C-5, and F-16. Shortages of spare parts occurred because of inaccurate forecasting of inventory requirements, and other management weaknesses.

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<sup>1</sup>Secondary inventory is defined as spare and repair parts, clothing, medical supplies, and other items needed to support operating forces.

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The vulnerability of in-transit inventory to waste, fraud, and abuse is another area of concern. In February 1998, we reported that DOD did not have receipts for about 60 percent of its 21 million shipments to end users in fiscal year 1997. Further, in examining in-transit issues in the Navy, we found that weaknesses continue to exist in exercising control over inventory in transit. Over the last 3 years, the Navy wrote off as lost over \$3 billion in inventory in transit, including some classified and sensitive items such as aircraft guided-missile launchers, military night vision devices, and communications equipment.

For many years, DOD has had difficulties in obtaining timely and accurate information on the location, movement, status, and identity of units, personnel, equipment, and supplies and the capability to better manage those assets using that information. To address this problem, DOD gave renewed emphasis to its Total Asset Visibility program for tracking equipment, supplies, and spare parts as well as requisitions on a continuous basis. However, DOD does not expect to fully implement this program until 2004. Program implementation problems have resulted largely from long-standing management issues that have hindered other major management initiatives. These issues include cultural resistance to change, service parochialism, and the lack of outcome-oriented goals, performance measures, and management accountability.

DOD must take both a short- and long-term approach to solving its inventory management problems, consistent with the requirements of the Government Performance and Results Act.<sup>2</sup> In the short term, DOD still needs to emphasize the efficient operation of existing inventory systems. In the long term, DOD must establish goals, objectives, and milestones for changing its culture and adopting new management tools and practices. Since 1991 we have issued 11 reports that identified significant opportunities, building on best private sector practices, to improve logistics operations and lower costs. DOD has introduced some best practice initiatives, but progress has been slow.

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<sup>2</sup>The Results Act requires federal agencies (including DOD) to develop departmentwide strategic and performance plans and reports. They must set strategic goals, measure performance, and report on the degree to which goals were met. This is expected to provide the Congress and other decision makers with objective information on the relative effectiveness and efficiency of federal programs. Annual performance plans are included as appendix J to the Secretary of Defense's Annual Report to the President and the Congress.

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In addition, DOD has recognized the need for improvements in the inventory management area and addressed the issue in implementing requirements of the Results Act. One performance goal included in DOD's recently issued performance plan for fiscal year 2000 is to streamline the DOD infrastructure by redesigning the Department's support structure and pursuing business practice reforms. Among the indicators the plan indicated DOD would track were (1) logistics response time, (2) materiel asset visibility and accessibility, and (3) reduction of supply system inventory of repair parts and finished goods. We encourage DOD to take more aggressive actions to correct systemic problems so that its inventory management problems will not continue well into the next century. And, corrective actions must be built on the strong underpinnings of management information systems capable of providing reliable and timely information needed for management decision making.

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## Background

DOD has had inventory management problems for decades, but with more attention drawn to the problems since the end of the Cold War. In 1990, we identified DOD's management of secondary inventories as a high-risk area because levels of inventory were too high and management systems and procedures were ineffective.<sup>3</sup> We reported that DOD had spent billions of dollars on inventory that was not needed to support war reserve or current operating requirements and that it was burdened with managing and storing this inventory. Much of the inventory that exceeds current requirements was acquired because of outdated and inefficient inventory management practices.

We reported in 1997 that DOD had made some progress, but significant challenges still remained. In an effort to apply industry best practices, DOD had implemented, in a limited manner, certain commercial practices such as a prime vendor<sup>4</sup> concept that could lead to reduced inventory requirements. However, we also reported that the concept had been applied only to about 3 percent of the items for which this concept could be

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<sup>3</sup>In 1990, we began a special effort to review and report on the federal program areas that we identified as high risk because of vulnerabilities to waste, fraud, abuse, and mismanagement. This effort, which was supported by the Senate Committee on Government Affairs and the House Committee on Government Reform, brought a much needed focus on problems that were costing the government billions of dollars. We identified inventory management as high risk in our 1992, 1995, 1997, and 1999 high-risk reports.

<sup>4</sup>Prime vendors are contractors that buy inventory items from a variety of suppliers, store them in commercial warehouses, and ship them to customers as needed.

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used. We also reported that DOD had made progress in reducing its inventory levels, but more remained to be done.<sup>5</sup> From 1989 through the end of fiscal year 1995, DOD reduced its secondary inventory levels from \$92.5 billion to \$69.6 billion. However, virtually all the problems that previously had contributed to billions of dollars of inventory that exceeded current needs still existed. For example, DOD still lacked adequate oversight of its inventory, financial accountability remained weak, and requirements continued to be overstated. Improvements were still needed in DOD's information management systems.

The results of our more recent work involving inventory issues show that despite additional progress in reducing inventory levels, previously existing problems remain a concern. Also, while DOD has continued to emphasize the need to move toward an industry best practices approach, more remains to be done in that area also.

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## Excess Inventory Levels Continue Despite Overall Reductions

Our recent work examining inventory issues shows that much of DOD's inventory remains significantly higher than needed to meet current requirements, even though DOD continues to make progress in reducing its inventory levels. Inventory levels we analyzed were reduced from \$69.7 billion as of September 30, 1996, to \$65.8 billion as of September 30, 1997. Yet, \$39.4 billion of the \$65.8 billion exceeded current requirements shown in DOD's requirements objective.<sup>6</sup> In other words, based on the requirements at September 30, 1997, DOD would not have bought \$39.4 billion of the inventory it had on hand. Further, the percentage of inventory that exceeded current requirements remained about 60 percent for the two periods analyzed and was about the same as of September 30, 1995.

We also found that DOD could potentially reduce inventory that exceeded current requirements. The Department had no demand for about \$11 billion of the inventory that exceeded current requirements as of September 30, 1997, but it did have customer demands for \$26 billion. However, assuming customer demands remain unchanged, \$3.4 billion of this inventory would last 20 or more years and \$658 million would last more

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<sup>5</sup>High-Risk Series: Defense Inventory Management (GAO/HR-97-5, Feb. 1997).

<sup>6</sup>The requirements objective represents the maximum amount of inventory authorized to sustain current operations, including the funded war reserves.

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than 100 years. Some of this inventory is more economical to retain than to dispose of and possibly repurchase. Yet, to the extent it is economical to dispose of the inventory, DOD's cost of operations could be reduced.

In addition to retaining greater inventory levels than required, inventories beyond current needs remain high because of new purchases, which total about \$13 billion annually. While new purchases may be initiated to meet justified requirements, those requirements frequently change after items are ordered. While some orders may be canceled, others may not, and not all of the new purchases may be needed. We found that as of September 30, 1997, DOD did not need about \$1.5 billion, or 18 percent, of the inventory it had ordered to meet current requirements. We reported in April 1998 that additional opportunities to cancel purchases had been missed because appropriate economic analyses were not made, conflicting inventory and contracting records were not reconciled, or item managers did not exercise their responsibilities to direct cancellations of contracts.<sup>7</sup>

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## Inventory Shortages Can Also Be a Problem

Although historically, DOD has carried significant amounts of inventory items in excess of current needs, it has also been faced with inventory shortages and other related supply problems that can adversely affect operational requirements. Our recent review examining Air Force supply management issues highlighted these problems.

We are now finalizing the results of our review of the supply management activity group<sup>8</sup> and its impact on the ability of its customers to obtain aircraft spare parts when needed. We found that since the early 1990's, data from the Air Force have shown increased instances of aircraft that were not mission capable due to spare parts shortages. Key aircraft that were not mission capable due to supply problems increased from an average of 6.4 percent in fiscal year 1990 to 13.9 percent in fiscal year 1998; for some types of aircraft the averages were much higher.

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<sup>7</sup>Navy Inventory Management: Improvements Needed to Prevent Excess Purchases (GAO/NSIAD-98-86, Apr. 30, 1998).

<sup>8</sup>The supply management activity group supports combat readiness by procuring materiel and making repair parts available to Air Force military units and other customers who maintain military weapon systems and equipment. This group is part of the Air Force Working Capital Fund, a revolving fund that relies on sales revenue, rather than direct appropriations, to finance its operations. Working capital funds are expected to (1) generate sufficient revenue to cover the full costs of their operations and (2) operate on a break-even basis over time—that is, not make a profit nor incur a loss. Customers primarily use operations and maintenance appropriations to pay for inventory items.

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Overall, more aircraft were not mission capable due to supply shortage problems in fiscal year 1998, even though Air Force bases have increased the removal of inventory items from one aircraft to keep other aircraft mission capable. This practice necessitated (1) personnel at individual bases intentionally grounding one or more aircraft so they could remove good parts from these aircraft to keep other aircraft mission capable, (2) maintenance personnel at Air Force wings consistently doubling their workload by removing inventory items from grounded aircraft to replace broken items on other aircraft, and (3) some Air Force units not always being able to perform their peacetime missions, such as required training, and others not being able to meet airlift requests.

Financial management, inventory management, and item repair problems resulted in parts shortages for 155 inventory items that we reviewed on B-1B, C-5, and F-16 aircraft. In fiscal year 1997, the Air Force's inability to determine its inventory requirements and budget for those requirements was the primary source of parts shortages.

More specifically, the Air Force's supply management activity group's fiscal year 1997 budget underestimated funding requirements for the group's wholesale division by about \$500 million because (1) all inventory requirements were not included in the budget and (2) inventory requirements increased after the Air Force had developed its budget. As a result, the supply management activity group could finance only 82 percent of its fiscal year 1997 inventory requirements. At the same time, supply managers exacerbated their fiscal year 1997 support problems by using their limited obligation authority to buy items that were excess to their current operating requirements. An indication of the magnitude of this problem was that, as of September 1997, the Air Force had reported \$1.7 billion of inventory items on order, of which about \$409 million, or about 24 percent, was excess to its current needs.

We found that many of the 155 items reviewed were problems, at least in part, because the Air Force did not achieve the reduced pipeline processing time goals that are the cornerstone of its Agile Logistics program<sup>9</sup> and that were the basis for a \$948 million reduction in the supply management activity group's budget. This untimely processing of repairable items

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<sup>9</sup>The objectives of the Agile Logistics program are to (1) reduce the time it takes to repair components and aircraft, (2) reduce the amount and costs of supply inventories, (3) match the repair of items with the demand from customers, and (4) prioritize repairs when multiple priorities exist.

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adversely affected the supply activity group's ability to support its customers because it caused the Air Force to have too many items in the supply pipeline (items in transit from bases to depots and items in the process of being repaired), and not enough useable items available at bases. Two major causes of the problem was (1) a lack of accurate data and effective procedures for monitoring pipeline processing times and taking timely and appropriate corrective action, when necessary and (2) that depot maintenance activities ability to repair items was limited by shortages of component parts to fix broken repairable items, repair shop personnel, and equipment used to test repairable items after being fixed.

In its fiscal year 2000 budget document for the supply group, the Office of the Under Secretary of Defense (Comptroller) raised concerns about the readiness of all military services and cited a lack of spare parts as a major contributor to the decline in the mission capability of aircraft. To help improve readiness, \$141.4 million in obligation authority was added to the Air Force supply group's fiscal year 2000 budget to buy and repair inventory items. However, the budget document raised concerns about the Air Force's ability to use this additional obligation authority to purchase the correct inventory items. Accordingly, the Deputy Secretary of Defense directed the Air Force Materiel Command to review the process it uses to review and revise the inventory requirements of its customers. This review is now underway and is to identify the underlying cause of the forecasting problems. A report is due to the Office of the Under Secretary of Defense by May 15, 1999.

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## Continuing Weaknesses in Adhering to Procedures for Controlling In-Transit Items

The vulnerability of in-transit inventory to waste, fraud, and abuse is another area of concern. In February 1998, we reported that DOD did not have receipts for about 60 percent of its 21 million shipments to end users in fiscal year 1997.<sup>10</sup> Among the DOD components, the Army accounted for about one fourth and the Navy accounted for about half of DOD's 12.4 million unacknowledged receipts. Later work shows that, over the last 3 years, the Navy alone wrote off as lost over \$3 billion in inventory in transit.

Recently, in examining in-transit issues in the Navy, we found that weaknesses continue to exist in exercising control over inventory in

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<sup>10</sup>Department of Defense: In-Transit Inventory (GAO/NSIAD-98-80R, Feb. 27, 1998).

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transit. As a result, enormous amounts of inventory are at risk of undetected theft or misplacement. For fiscal years 1996 through 1998, the Navy reported in-transit inventory losses totaling over \$3 billion, including some classified and sensitive items such as aircraft guided-missile launchers, military night vision devices, and communications equipment.

The Navy's Inventory Control Point (NAVICP) at Philadelphia, which manages the largest portion of the Navy's inventory, reported the largest losses, \$2.5 billion, or 84 percent of the Navy's in-transit losses. However, our work at NAVICP Philadelphia showed that some of the items reported as lost had, in fact, been accounted for in inventory records. We reviewed 94 shipments and found that 15 had been written off as lost despite the fact that their receipts were recorded in the inventory records in advance of the date they were written off.

Navy activities involved in issuing and receiving inventory items have not routinely followed the Navy's control procedures to ensure that in-transit items are accounted for. Specifically, concerning NAVICP Philadelphia, we found that: (1) Navy units have not always reported to the inventory control point that they received requested items, (2) ineffective accounting systems have been used to monitor receipts of warehoused items, (3) the NAVICP and its shipping and receiving activities have not adequately investigated unreported receipts of warehoused items, and (4) the NAVICP has not monitored receipts of items it purchased from commercial sources.

We also found that oversight of in-transit inventories exercised by the Naval Supply Systems Command and NAVICP Philadelphia has not been adequate. Systems Command officials acknowledged that, to date, they had not actively monitored in-transit inventory receipt and follow-up efforts but had recently begun to review both systems and processes to correct weaknesses. However, they have not established any performance measures, milestones, or a timetable for reducing the vulnerability of in-transit inventory to theft or loss.

The Strom Thurmond National Defense Authorization Act for Fiscal Year 1999 requires DOD to develop a comprehensive plan to ensure visibility over in-transit items and to submit its plan to the Congress by March 1, 1999. For secondary items, DOD must address such issues as the vulnerability of in-transit items to loss through fraud, waste, and abuse; loss of oversight of in-transit items, including loss when items are being transported by commercial carriers; and loss of accountability for in-transit

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items due to either a delay of delivery of the items or a lack of notification of the delivery.

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## Continuing Efforts to Achieve Total Asset Visibility

For many years, DOD has had difficulties in obtaining timely and accurate information on the location, movement, status, and identity of units, personnel, equipment, and supplies, and the capability to better manage those assets using that information. The continuing lack of adequate visibility over operating materials and supplies substantially increases the risk that millions of dollars will be spent unnecessarily to acquire more items than would be needed if a clearer, more accurate picture existed of items in inventory, in-transit, and in theater, and asset managers had the ability to access and transfer those items. Asset visibility began to receive heightened attention during the Gulf War when logistics pipelines became clogged with thousands of duplicate requisitions, and more than half of the 40,000 large containers of equipment shipped in theater could not be readily identified.

To address this problem, DOD gave renewed emphasis to its Total Asset Visibility (TAV) program for tracking equipment, supplies, and spare parts as well as requisitions on a continuous basis.<sup>11</sup> In 1995, we reported that DOD's strategic plans for logistics called for improving asset visibility over in-transit assets, retail level stocks, and automated systems.<sup>12</sup> DOD's goal initially was to completely implement its asset visibility plan by 1996. It later changed that date to 2001, and subsequently extended it out to 2004. Even so, significant issues remain to be resolved if DOD is to achieve its goals for this program.

DOD's Performance Plan for Fiscal Year 2000, developed in response to the Government Performance and Results Act, defines asset visibility as the percentage of DOD's worldwide inventory in storage that is both visible and accessible to Integrated Materiel Managers (IMMs). It states that IMMs are the DOD organizations assigned wholesale management responsibility for specific assets or classes of assets Departmentwide. The plan notes that 94 percent of DOD's worldwide inventory is to be visible to military services or Defense agency tracking systems but only 80 percent is accessible by the appropriate IMMs who have wholesale management responsibilities for

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<sup>11</sup>Defense Total Asset Visibility Implementation Plan, USD (A&T), May 23, 1996.

<sup>12</sup>High Risk Series: Defense Inventory Management (GAO/HR-95-5, Feb. 1995).

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specific assets or classes of assets.<sup>13</sup> The plan attributes the lack of visibility to data system interoperability problems. It states that the Department's strategy for fiscal year 2000 is to enhance the interface among the services and Defense agencies to achieve a TAV level of 90 percent. It notes that a potential complication in executing the strategy is the fact that TAV initiatives must compete with Year 2000 (Y2K) requirements for scarce information technology resources but that sufficient management attention would be placed on the timing of system changes to mitigate the risks of funding shortfalls.

Our recent work found that while some component and theater-specific asset tracking capabilities are reported to be operating, DOD-wide information on progress in achieving TAV Program goals is minimal. Consequently, although implementing improved asset visibility is a high priority objective, DOD is uncertain about the extent to which it is achieving the objectives of having timely, accurate information on requisitions and assets and access to DOD assets.

Along with an unclear picture of the program's status, planning for TAV has been inadequate at the strategic and implementation levels. DOD does not have a departmentwide TAV strategic plan to show how the various TAV initiatives underway within individual DOD components contribute to DOD's goals for the Program.

While lacking a strategic plan, DOD does have an "implementation plan" for TAV, although it has a number of weaknesses. The implementation plan has established some broad program goals and areas of emphasis, but it does not describe how TAV will be integrated into DOD work processes to realize TAV Program goals. The plan also does not state how TAV systems will integrate with and/or support other management information systems. This is particularly important as it relates to financial management systems and reporting.

TAV implementation problems have resulted largely from long-standing management issues that have hindered other major management initiatives. These issues include cultural resistance to change, service parochialism, and the lack of outcome-oriented goals, performance

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<sup>13</sup>Our recent work has found that the 94-percent visibility and 80-percent accessibility are against the National Performance Review (NPR) goals. These NPR performance measures do not include inventories in process or in transit.

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measures, and management accountability. Resistance to changing from reliance on just-in-case inventory approaches to just-in-time inventory approaches is a significant challenge for DOD in its approach to inventory management. Further, this new way of doing business requires timely and accurate information about quantities and locations of items and a willingness by item holders to transfer items to meet the priority needs of others. Over time, we believe that the Results Act, with its strategic planning and reporting requirements, and the Clinger/Cohen Act, which emphasizes a performance-based approach to information technology investments, could enhance DOD's efforts to provide an effective framework for addressing TAV's implementation challenges, and achieving its program goals.

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## Continuing Need to Expand Use of Industry Best Practices

We recently addressed Defense inventory management issues in our Performance and Accountability Series dealing with major management challenges and program risks.<sup>14</sup> We noted that since 1991, we have issued 11 reports that identify significant opportunities for DOD to test and adopt, where feasible, best inventory management practices used in the private sector to improve logistics operations and lower costs. The business practices we recommended have, for the most part, been used in the private sector to enable customers to order supplies as they are needed and receive them within hours.

For example, some commercial airlines have cut costs and improved customer service by streamlining their overall logistics operations. The most successful improvements took a supply-chain management approach, which included using highly accurate information systems to track and control inventory; employing various methods to speed the flow of parts through the logistics pipeline; shifting certain inventory tasks to suppliers; and having third parties handle parts repair, storage, and distribution functions.

Improved acquisition and delivery practices can reduce overall supply system costs, eliminate large inventories, and enable companies to reduce or eliminate the ordering of supplies that may not be needed or become obsolete. To achieve similar inventory reductions, infrastructure savings, and improved customer service, we have recommended that DOD expand

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<sup>14</sup>Major Management Challenges and Program Risks, Department of Defense (GAO/OCG-99-4, Jan. 1999)

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its current initiatives to their fullest extent and include tasks such as ordering, storing, and distributing supplies to the customer.

DOD through its Defense Logistics Agency (DLA) has continued to emphasize the use of prime vendors to manage parts, reduce government inventories, and improve delivery times. However, limited progress has been made in expanding use of prime vendors for all classes of consumable items, particularly hardware items. Hardware items represent 97 percent of the 4 million items managed by DLA but accounted for only 1 percent of prime vendor sales in fiscal year 1997.

Recently, the Congress enacted legislation requiring DLA and the military services to develop and submit schedules for implementing best commercial practices in its acquisition and distribution of inventory items. The legislation calls for the implementation of best practice initiatives to be completed within the next 3 years in the case of DLA and 5 years for the services. We are currently reviewing the implementation of these initiatives.

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## Conclusion

DOD must take both a short- and long-term approach to solving its inventory management problems, consistent with the requirements of the Government Performance and Results Act. In the short term, DOD still needs to emphasize the efficient operation of existing inventory systems. In the long term, DOD must establish goals, objectives, and milestones for changing its culture and adopting new management tools and practices. Since 1991 we have issued 11 reports that identified significant opportunities, building on best private sector practices, to improve logistics operations and lower costs. DOD has introduced some best practice initiatives, but progress has been slow.

In addition, DOD has recognized the need for improvements in the inventory management area and addressed the issue in implementing requirements of the Results Act. One performance goal included in DOD's recently issued performance plan for fiscal year 2000 is to streamline the DOD infrastructure by redesigning the Department's support structure and pursuing business practice reforms. Among the indicators the plan indicated DOD would track were (1) logistics response time, (2) materiel asset visibility and accessibility, and (3) reduction of supply system inventory of repair parts and finished goods. We encourage DOD to take more aggressive actions to correct systemic problems so that its inventory management problems will not continue well into the next century. And,

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corrective actions must be built on the strong underpinnings of management information systems capable of providing reliable and timely information needed for management decision making.

DOD's Annual Performance Plan for fiscal year 2000 acknowledged that the supply inventory is larger than required to support today's smaller force structure. It reported that the goal is to cut holdings from a fiscal year 1989 high of \$107 billion to \$56 billion by fiscal year 2000 and \$48 billion by fiscal year 2003. It noted, however, that improvements in total asset visibility might cause documented inventory levels to increase. It also noted that, selective inventory increases are being made in some areas (notably aircraft parts) in response to operational requirements. It stated that a new model reflecting these factors is expected to produce revised inventory goals in late fiscal year 1999.

DOD's conceptual framework for the future calls for the military services to fuse information, logistics, and transportation technologies in a manner that will allow them to (1) provide rapid crisis response; (2) track and shift assets, even while enroute; (3) deliver tailored logistics packages when and where needed; and (4) ensure the availability of spare parts and other items to sustain combat operations. The concept is based, in part, on the premise that supply managers will have precise visibility over assets and will be able to make rapid and accurate logistics assessments and analyses, when necessary. While the concept appears sound, it requires coordination of multiple organizations, systems, and processes to be effective. And, it requires the strong underpinnings of management information systems capable of providing reliable and timely information needed for management decision making.

Mr. Chairman, this concludes my prepared remarks. I would be pleased to answer any questions that you or Members of the Subcommittee might have.

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