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United States General Accounting Office

GAO

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

May 1994

ARMY INVENTORY

Changes to Stock
Funding Reparables
Would Save Operations
and Maintenance
Funds



3108 94-18620



GAO/NSIAD-94-131

National Security and
International Affairs Division

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

Dear Mr. Chairman:

This report responds to your request that we review the Army's implementation of the Department of Defense's (DOD) requirement to fund the procurement of reparable items through a stock fund, called stock funding of depot level reparables (SFDLR). More specifically, you asked that we determine whether SFDLR (1) has reduced demands on and procurements by the wholesale level supply system and (2) has affected management of maintenance and inventory activities and use of operation and maintenance (O&M) funds at the unit level. The scope and methodology of our review are discussed in appendix I.

Background

Before April 1992, Army units received reparable items from the wholesale level at no cost. Consequently, there was little incentive to repair unserviceable items at the local level or return the items to the wholesale level for repair. As a result, unserviceable items accumulated at the unit level, and the wholesale level continued buying the same items.

The Navy had experienced similar problems. In 1981, the Navy decided to procure shipboard reparable items at the wholesale level with stock funds rather than procurement funds and require its shipboard units to use O&M funds to purchase these items. In 1985, procurement of aviation reparables was converted to the stock funding concept. The reasoning was that if the units had to pay for the items, they would be more inclined to repair the items locally and to return those items that could not be repaired locally to wholesale level repair depots.

According to DOD, the Navy's experience with stock funding reparables improved Navy units' management and control of reparable items. Further, the Navy's return rate of unserviceable items to the depots increased, and demands and procurements at the wholesale level decreased.

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The success of the Navy's experience led DOD to direct the Army and the Air Force to implement a similar practice.¹ In October 1990, the Army began procuring its reparables at the wholesale level with stock funds, and in April 1992, Army units were required to use O&M funds to purchase items.

Results in Brief

The Army's switch to SFDLR helped reduce demands for reparable items about 55 percent—from \$8.3 billion in fiscal year 1991 to \$3.7 billion at the end of fiscal year 1993. The decreased demands enabled the wholesale system to reduce its procurement of reparables about 75 percent, from \$1.8 billion to \$443 million during the same period.

The SFDLR implementation plan intended that on an aggregate basis by material category, units would receive the same credit for items turned in to the retail stock fund that was granted by the wholesale stock fund to the retail stock fund. However, the Army's credit policy has enabled units to increase their O&M buying power. For example, in fiscal year 1993, Army units increased their O&M purchasing power by \$201 million because the retail stock fund granted more credit to O&M customers than the wholesale stock fund reimbursed the retail stock fund.

At the same time that units have increased their O&M funds, Army units at the installation level are spending O&M funds to repair items that are in long supply² at the wholesale level. From an individual unit's perspective, they can repair the item cheaper than procuring the item from the wholesale system. However, from an Army-wide perspective, the use of O&M resources for this purpose does not make good business sense.

The Army is testing, or plans to test, certain initiatives to address these problems. For example, the Army

- plans to test a single stock fund initiative that would eliminate the retail stock fund and link the amount of credit units received to the amount of credit given by the wholesale stock fund;

¹The Air Force implemented the stock funding concept in October 1992. The Air Force's experiences with SFDLR are not addressed in this report because of the lack of readily available data to track its experiences.

²Long supply is when the number of inventory assets exceeds the current operating and war reserve requirements.

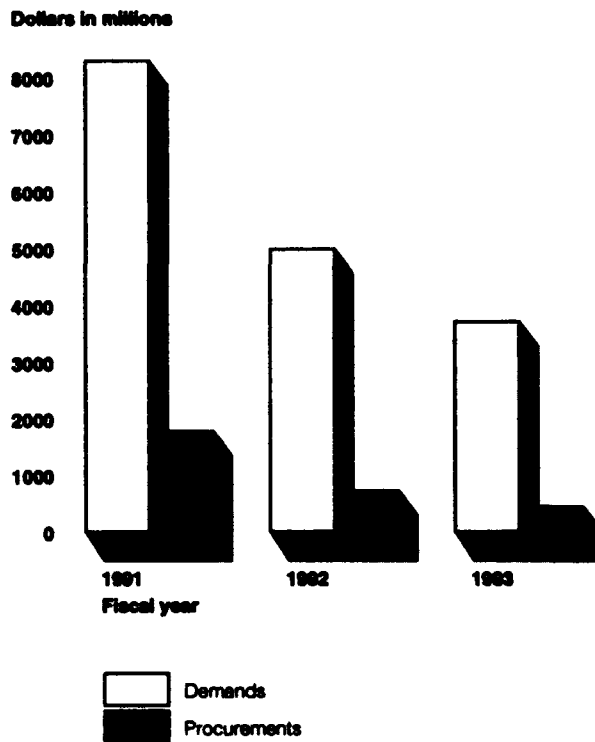
- is offering, at a reduced price, some items that are in long supply at the wholesale level to units so that the units will not repair these items at the local level; and
- wants to develop a new maintenance concept where the wholesale level decides what to repair based on Army-wide visibility of items needing repair.

These initiatives will not solve all the problems identified in our review because (1) there is much resistance at the unit level to the elimination of the retail level stock fund and it is questionable that the single stock fund initiative will be tested or implemented, (2) many items in a long-supply position at the wholesale level are not being offered to the units at a reduced price, and (3) under the new maintenance concept, the decision as to what should be repaired is being made at the local level and not the wholesale level.

Item Demands on and Procurements by the Wholesale System Have Decreased

Demands on and procurements by the wholesale system for reparable items have decreased significantly since SFDLR was implemented in April 1992. As shown in figure 1, demands decreased from \$8.3 billion in fiscal year 1991 to \$3.7 billion in fiscal year 1993. Over the same period, procurements decreased from \$1.8 billion to \$443 million.

Figure 1: Wholesale Level Demands and Procurements Before and After SFDLR



While SFDLR was a contributing factor to these decreases, there were other factors as well. For example:

- The downsizing of the Army reduced the number of equipment items that need to be maintained. Therefore, in total, units are not repairing as many items.
- Congress imposed a limit on the amount of procurements equal to 65 percent of sales from the wholesale system. Consequently, the wholesale system could not replace all of the items that it sold to the retail level.
- Operation Desert Storm resulted in many units increasing the number and quantity of inventory items in anticipation of a prolonged conflict. Because of the short duration of the war, units returned with excess inventories and are continuing to use these items. Consequently, demands on the wholesale level have decreased.

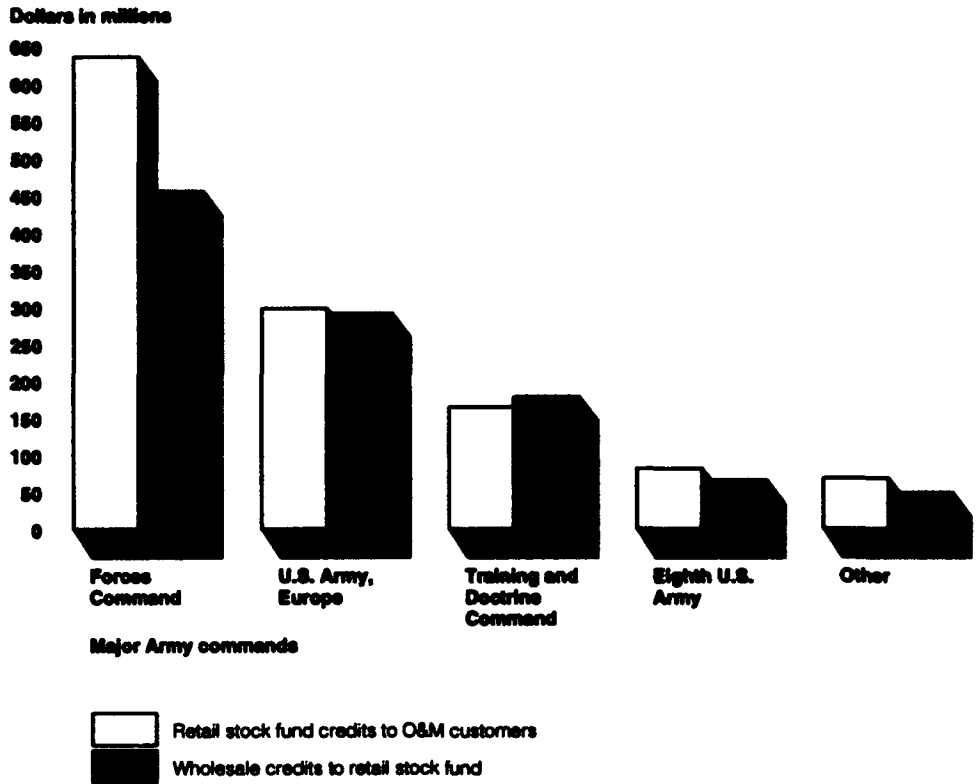
- Many Army units received new modern equipment such as tanks, armored personnel carriers, and helicopters. As a result, maintenance workload and demands for repair parts have not yet materialized.

Army Credit Policy Allows Units to Increase Their O&M Buying Power

The Army's credit policy allows units to increase their O&M buying power. When units turn in an item, they receive credit from the retail stock fund, regardless of whether the wholesale level needs the item. The retail stock fund, however, will not receive credit for items turned in to the wholesale level if the wholesale stock fund does not need the item. As a result, the Army retail stock fund often grants more credit than it receives.

As shown in figure 2, the retail stock fund gave credit totaling \$1.251 billion in fiscal year 1993 and received credit totaling \$1.050 billion from the wholesale stock fund—a \$201-million deficit. This has caused a cash drain on the wholesale system, which is part of the Defense Business Operating Fund.

Figure 2: Credit Awarded for Returned Items by Army Major Command



The \$201 million represents increased O&M funds that the units can use for other purposes. At the Forces Command, where the retail stock fund credited \$181 million more to its customers than the wholesale stock fund credited to the retail stock, the Chief of the Program Budget Branch said \$88 million was for items the wholesale level did not need and directed the retail stock fund to send the items to disposal. The remaining \$93 million was for items the wholesale system took back but did not grant credit for because the items' inventory levels at the wholesale level exceeded the current operating and war reserve requirements but were within the maximum amount that can be retained.

According to the Army's SFDR implementation plan, the intent was that units would only receive credit from the retail stock fund equal to what the retail stock fund received from the wholesale stock fund. However, according to the Chief of the Secondary Items Division in the Office of the

Army's Deputy Chief of Staff for Logistics, the Army did not link the amount of credit received by the units on an item-by-item basis to the amount of credit given by the wholesale stock fund. Instead, the Army linked it to an aggregate credit based on material category. The Army did not want to penalize units' operating tempo because the items they turned in were in an excess supply position at the national level. Additionally, the Army assumed that as long supply at the wholesale level declined, the amount of credit given to the units and the amount of credit given by the wholesale level would balance.

The amount of credit a unit receives depends on whether the item is in a serviceable or unserviceable condition and is needed by the retail stock fund. Units receive a credit equal to the standard price³ for a serviceable item if the item is needed by the retail stock fund. For an unserviceable item, the unit receives a credit equal to the standard price less the repair cost if the retail stock fund needs the item. For serviceable and unserviceable items not needed by the retail stock fund, the unit received a credit equal to about 54 percent of the standard price in fiscal year 1993. In fiscal years 1994 and 1995, the credit will be reduced to 52 percent and 47 percent, respectively.

The amount of credit the wholesale stock fund gives the retail stock fund for items not needed at the retail level or requiring repair at the wholesale level depends on whether the wholesale system needs the item. If a serviceable item is needed at the wholesale level (i.e., the asset position of the item is within the Approved Acquisition Objective⁴), the retail stock fund receives a credit equal to the standard price less a surcharge.⁵ If the serviceable item is not needed, the retail stock fund receives no credit and will either return the item to the wholesale inventory or send it to disposal.

If the wholesale system needs an unserviceable item, the retail stock fund will receive a credit equal to 50 to 60 percent of the standard price. If the item is not needed at the wholesale level, the retail stock fund receives no credit and will dispose of it.

³Standard price is the latest acquisition price plus a surcharge.

⁴The Approved Acquisition Objective includes quantities to support ongoing operations, safety levels, and war reserve requirements.

⁵The Army surcharge for fiscal year 1993 was 19.3 percent. It includes the cost of operations at the inventory control points, transportation and distribution, inflation, and inventory losses.

Installations Are Repairing Items That Are in Long Supply at the Wholesale Level

Army units are spending O&M funds to repair items at the retail level that are in long supply at the wholesale level. The situation occurs because if a unit orders a replacement item from the wholesale level and turns in an unserviceable item, the unit would have to pay the repair cost and a surcharge equal to about 19 percent of the acquisition price. If the unit repaired the item locally, it would avoid paying the surcharge, and in most cases, the repair cost at the local level is less than the repair cost at the wholesale level. Therefore, from an individual unit perspective, it is cheaper to repair the item locally than to buy it from the wholesale level. However, from an Army-wide perspective, it is not prudent management to spend O&M resources when there are unneeded items at the wholesale level.

Table 1 shows examples of items being repaired at Fort Hood, Texas, from October 1992 through June 1993.

Table 1: Items Being Repaired at Fort Hood, Texas, That Were in Long Supply at the Wholesale Level

Item	Repaired at local level		Number of items in long supply
	Number	Total repair cost	
M-88 engine	39	\$735,250	45
CUCV transfer transmission	35	12,023	1,731
CUCV fuel pump	63	15,134	3,013
M-109 transmission	7	21,151	638
Steering gear kit	13	12,115	907

Source: Army Materiel Command Budget Stratification Reports and Fort Hood Directorate of Logistics repair data.

Army Initiatives to Address the Problems

The Army is testing, or plans to test, several initiatives that will address (1) the disparity between the amount of credit given to units by the retail stock fund and the amount of credit received from the wholesale stock fund and (2) the problem of units repairing items that are in long supply at the wholesale level. Although these initiatives are a step in the right direction, they will not completely resolve the problems. Furthermore, in certain cases, it is questionable that the initiatives being tested ever will be implemented throughout the Army.

Eliminating the Disparity Between Credits at the Retail and Wholesale Levels

The Army plans to test a single stock fund initiative in June 1994. The test is expected to last 6 months. When the test is completed, the results will be evaluated and a decision will be made about further testing and implementation. As designed, the single stock fund would do away with the retail stock fund and extend ownership, control, and visibility of installation stocks to the wholesale system. With only one stock fund, as compared to the two stock funds that currently exist, the problem of the retail stock fund giving more credit to units turning in items than it receives from the wholesale stock fund would disappear.

There are concerns at the unit level about implementing a single stock fund. The major concern seems to be that if the Army went to a single stock fund, the amount of credit that units received for items turned in would be limited to the credit given by the wholesale system. In other words, units would no longer be able to increase their O&M buying power to the extent that they were able to achieve in 1993 by getting more credit from the retail stock fund than was reimbursed by the wholesale stock fund.

The single stock fund test was initially planned to begin in July 1993. It was postponed until December 1993, then March 1994, and is now scheduled to begin in June 1994.

The issue of a single stock fund is one that the Army has been confronted with for a long time. In 1987, the Logistics Management Institute identified the need for a single stock fund. At that time, it was referred to as "vertical stock fund." In 1990 and again in 1991,⁶ we recommended that the Army adopt a single stock fund as a way to improve the management of its inventory system. Because of the problems and delays with the single stock fund test and the concerns about implementation of a single stock fund, it is uncertain whether the Army will resolve the single stock fund issue. If changes are not made, an imbalance between the amount of credit given by the retail stock fund to O&M customers and the amount of credit given to the retail stock fund by the wholesale stock fund will continue.

Army Will Reduce the Price of Items in Long Supply

In fiscal year 1994, the Army is offering selected items that are in long supply at the wholesale level to units at a reduced price. The intent is to encourage units to buy the long supply items rather than repair them

⁶Army Inventory: A Single Supply System Would Enhance Inventory Management and Readiness (GAO/NSIAD-90-53, Jan. 25, 1990) and Army Inventory: Fewer Items Should Be Stocked at the Division Level (GAO/NSIAD-91-218, July 24, 1991).

locally. By doing so, the units can optimize the use of O&M funds and, at the same time, reduce the level of long supply items at the wholesale level.

The Army has identified 122 items to be included in the reduced price program. The reduced price items are focused on older systems that have no projected procurements. Other long supply items are being repaired at the local level, but are not being offered at a reduced price.

From October 1992 to June 1993, Fort Hood repaired 54 different SFDLR items. Of the 54, 7 were included on the Army's list of reduced price items. From the remaining 47 items not included on the list, we selected 21 items and determined that 12 were in long supply at the wholesale level. For example, the M-88 recovery vehicle's transmission and engine are being repaired at Fort Hood and are also in long supply at the wholesale level. If the Army wants to reduce its long supply assets at the wholesale level and encourage units not to repair these items, then the list of long supply assets offered at a reduced price should be increased.

Army officials commented that management officials need to retain the prerogative as to which long supply assets are offered at a reduced price. Their position is that the extent of the long supply and the potential to recapture the total cost of the item may exclude some long supply assets from the reduced price program.

A New Maintenance Concept to Address Local Repair of Long Supply Items

The Army began a proof of principle test in November 1993 on a new maintenance concept—integrated sustainment maintenance—that may address the issue of repairing items at the local level that are in long supply at the wholesale level. As initially envisioned, all maintenance resources above the direct support level would be under the control of the wholesale level maintenance manager—the Army Materiel Command. The wholesale level maintenance manager would manage the general support and depot maintenance facilities based on Army-wide maintenance needs. In this context, the wholesale manager would know which items are in long supply and, therefore, should not be repaired.

The integrated sustainment maintenance concept being tested, however, is a modified version of the initially designed program. The III Corps Commander, who is hosting the proof of principle test at Fort Hood, did not want to relinquish control of his maintenance resources and assets to the wholesale system. Therefore, the test is being conducted on a regional basis with the Corps Support Command acting as the regional

maintenance manager. Under this arrangement, the Army Materiel Command identifies its wholesale maintenance needs to the Corps Support Command, which programs these needs into the three regional maintenance facilities in III Corps.

The proof of principle test is scheduled to end July 31, 1994. At that time, the test results will be evaluated and a decision will be made whether to test the concept further or to implement it on an Army-wide basis. According to the Integrated Sustainment Maintenance Project Manager, if the Army decides to implement the concept, a decision will have to be made whether to use a regional maintenance manager or a national maintenance manager.

In our opinion, a national maintenance manager would be in the best position to know from an Army-wide perspective what items should be repaired and to ensure that items in long supply are not repaired. If the Army decides to implement integrated sustainment maintenance using a national maintenance manager, a question arises as to whether additional testing would be required since the proof of principle test was conducted using a regional version of the maintenance concept.

Recommendations

We recommend that the Secretary of the Army

- revise the credit rate for items turned in by units so that the amount of credit received by the units is linked to the amount of credit given by the wholesale system and
- expand the number of long supply items being offered at a reduced price—not just those items for the older systems that do not have a projected procurement—to encourage the units to buy the items rather than repair them at the local level. The reduced price to the units should be less than the repair cost at the local level. Otherwise, the units will continue to repair the items locally.

Agency Comments

DOD generally agreed with our findings and fully agreed with the recommendations. In those cases where DOD partially agreed with the information, we clarified the report to address their concerns.

With regard to the recommendations, DOD stated that the credit rates for items returned to the supply system have been revised for fiscal year 1994 and will be further adjusted in fiscal year 1995. DOD said that the credit

adjustments, along with a reduction in the amount of excess items turned in by the units, are intended to address the credit imbalance problem that occurred in fiscal year 1993.

DOD also said that it will expand the list of items that will be offered to the units as part of the reduced price initiative. Furthermore, according to DOD, representatives from all the Army inventory control points met in April 1994 to nominate additional item candidates to be included in the initiative in fiscal year 1995. The decision as to which items were added to the reduced price initiative was based on the magnitude of the long supply situation and the opportunity to recover the full cost of the item. DOD's comments appear in appendix II.

We are sending copies of this report to the Director of the Office of Management and Budget; the Chairmen of the House Committee on Government Operations, the Senate Committee on Governmental Affairs, the House and Senate Committees on Appropriations, and the Senate Committee on Armed Services; and the Secretaries of Defense and the Army. Copies will also be made available to other parties on request.

Please contact me at (202) 512-5140 if you or your staff have any questions. Major contributors to this report are listed in appendix III.

Sincerely yours,



Mark E. Gebicke
Director, Military Operations
and Capabilities Issues

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Abbreviations

DOD	Department of Defense
O&M	operation and maintenance
SFDLR	stock funding depot level reparable

Scope and Methodology

We performed our review at selected Army units to determine how the units planned for and implemented the stock funding depot level reparables (SFDR) concept. We analyzed workload, demand, and procurement data at the units and at the wholesale level to determine what effect implementation of SFDR had on the Army's maintenance and supply activities. We also held discussions with Department of Defense (DOD) and Army officials at the unit and headquarters level to obtain their views concerning SFDR. The locations in our review included the following:

- U.S. Army Office of the Deputy Chief of Staff for Logistics, Washington, D.C.;
- Defense Reutilization Marketing Service, Battlecreek, Michigan;
- Army Materiel Command, Washington, D.C.;
- Aviation and Troop Support Command, St. Louis, Missouri;
- Tank-Automotive Command, Warren, Michigan;
- U.S. Forces Command, Fort McPherson, Georgia;
- III Corps at Fort Hood, Texas;
- Fort Carson, Colorado;
- Eighth U.S. Army, Seoul, Korea;
- Corpus Christi Army Depot, Corpus Christi, Texas; and
- Red River Army Depot, Texarkana, Texas.

At the Army headquarters level, we obtained overall statistics concerning maintenance workload, demand, and procurement trends to assess whether SFDR was resulting in decreases in demands and procurements at the wholesale level. We interviewed officials to determine how they measure the success of SFDR and whether the intended results were being achieved. We also obtained the policies and procedures used by the services to encourage the units to repair more at the lower echelons of maintenance and/or to return the unserviceable items to the wholesale level for repair.

In order to determine whether Army units were repairing items that are in long supply or being disposed of at the wholesale level, we obtained data from the Work Order Logistics File maintained by the Army Materiel Command and from the list of items sent to disposal that are maintained by Defense Reutilization and Marketing Service. We compared the list of items being repaired at the Army unit level to the list of items in long supply at the Army wholesale level as well as the items being sent to disposal.

Appendix I
Scope and Methodology

We did not address how the Air Force implemented SFDLR. We could not determine the effect that SFDLR had on Air Force supply and maintenance activities because the Air Force does not maintain this type of data. Furthermore, the Air Force is in the process of implementing a new maintenance concept—Two Level Maintenance—with objectives that are not compatible with those of SFDLR. Whereas SFDLR has the objective of increasing repair at the base level, Two Level Maintenance emphasizes repair at the depot level. We plan to address the intended benefits of Two Level Maintenance in a future assignment.

We performed our review from May 1993 to January 1994 in accordance with generally accepted government auditing standards.

Comments From the Department of Defense



OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

(Financial Systems)

MAY 11 1994

Mr. Mark E. Gebicke
Director, Military Operations and
Capabilities Issues
National Security and International
Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Gebicke:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, entitled--"ARMY INVENTORY: Changes to Stock Funding Reparables Would Save Operation and Maintenance Funds," dated March 25, 1994 (GAO Code 703031), OSD Case 9630. The DoD partially concurs with the report.


As recognized by the GAO, Army credit policy allows units to increase operation and maintenance buying power by receiving credit from the retail stock fund when an item is turned in. The DoD agrees that the buying power of the operation and maintenance units is increased when credit is granted.

The DoD does not agree with the GAO conclusion that use of operation and maintenance funds for Army units to repair items is not prudent if those items are in long supply at the wholesale level. When local repair is performed for depot level reparable items, the repair is normally limited, less complex, and done at less cost than a depot level repair. Increased local diagnosis and repair is, in fact, a desired result when the item is in a long supply position at the wholesale level.

In addition, the GAO report recognizes that the Army has several initiatives underway to resolve the disparity between the amount of credit at the retail and wholesale levels. The primary initiative is the revision of the credit rates from 54 percent in FY 1993 to 47 percent in FY 1995. Also, the Army is expanding the number of items included in the reduced price initiative. The Army initiatives should significantly increase the processing efficiency of stock funding reparables.

The detailed DoD comments on the report findings and recommendation are provided in the enclosure. The DoD appreciates the opportunity to comment on the draft report.

Sincerely,



Richard P. Keevey
Deputy Comptroller
(Financial Systems)

Enclosure

GAO DRAFT REPORT - DATED MARCH 25, 1994
(GAO Code 703031) OSD CASE 9630

"ARMY INVENTORY: CHANGES TO STOCK FUNDING REPARABLES
WOULD SAVE OPERATION AND MAINTENANCE FUNDS"

DEPARTMENT OF DEFENSE COMMENTS

* * * *

FINDINGS

- **FINDING A: Stock Funding Depot Level Reparables.** The GAO observed that, before April 1992, Army units received reparable items from the wholesale level at no cost. The GAO further observed that, under such an arrangement, there was little incentive to repair unserviceable items at the local level or return the items to the wholesale level for repair. The GAO noted that, as a result, unserviceable items accumulated at the unit level and the wholesale level continued buying the same items.

The GAO reported that, in 1981, the Navy began procuring repairable items at the wholesale level with stock funds--rather than procurement funds--and requiring shipboard units to use operation and maintenance funds to purchase the items. The GAO observed that, if the units had to pay for the items, the units would be more inclined to repair the items locally and to return items that could not be repaired locally to wholesale level repair depots. The GAO indicated that the Navy experience improved the management and control of reparable items at Navy units. The GAO noted that (1) the Navy return rate of unserviceable items to the depots increased and (2) demands and procurements at the wholesale level decreased. The GAO further reported that the Navy experience led the DoD to direct the Army and the Air Force to implement a similar practice. The GAO pointed out that, in October 1990, the Army began procuring reparables at the wholesale level with stock funds and in, April 1992, Army units were required to use operation and maintenance funds to purchase items. (pp. 1-2/GAO Draft Report)

DOD RESPONSE: Concur.

- **FINDING B: Item Demands On, and Procurements By, the Army Wholesale System Have Decreased.** The GAO reported that demands on the Army wholesale system for reparable items had decreased from \$8.3 billion in FY 1991 to \$3.7 billion in FY 1993. The GAO noted that, during the same period, procurements decreased from \$1.8 billion to \$443 million. The GAO concluded that, while stock funding depot level

Now on pp. 1-2.

reparables was a contributing factor to their decreases, there were other factors as well, including the following:

- the reduction in the size of the Army--which, in turn, reduced the number of equipment items that must be maintained--resulting in units not repairing as many items;
- OPERATION DESERT STORM, which resulted in many units increasing the number and quantity of inventory items in anticipation of a prolonged conflict--however, because of the short duration of the war, units returned with excess inventories that are currently being used by the units; and
- many Army units received new modern equipment, such as tanks, armored personnel carriers, and helicopters--which have not yet generated demands for repair parts or maintenance workload. (pp. 4-5/GAO Draft Report)

DOD RESPONSE: Concur.

- FINDING C: ARMY Credit Policy Allows Units to Increase the Operation and Maintenance Buying Power. The GAO found that the Army credit policy allows units to increase operation and maintenance buying power. The GAO explained that, when units turn in an item, a credit is received from the retail stock fund, regardless of whether the wholesale level needs the item. The GAO further explained that the retail stock fund will not receive credit for items turned into the wholesale level if the wholesale stock fund does not need the item. The GAO concluded that, as a result, the Army retail stock fund often grants more credit than it receives. The GAO pointed out that, in FY 1993, the retail stock fund gave credits totaling \$1.251 billion and only received credits totaling \$1.050 billion from the wholesale stock fund, creating a \$201 million imbalance.

The GAO found the intent of the stock funding depot level reparables plan was that units would only receive credit from the retail stock fund equal to what the retail stock fund received from the wholesale stock fund. The GAO further found, however, that the Army did not link the amount of credit received on an item-by-item basis to the amount of credit given by the wholesale stock fund. The GAO observed that the amount of credit a unit receives depends on whether the item is in a serviceable or unserviceable condition and whether it is needed by the retail stock fund. The GAO also observed that the amount of credit the wholesale stock fund gives the retail stock fund for items not needed at the retail level or requiring repair at the wholesale level depends on whether the wholesale system needs the item. The GAO noted that, if the wholesale system

needs an unserviceable item, the retail stock fund will receive a credit equal to 50 to 60 percent of the standard price.

The GAO concluded the Army practice is unlike that of the Air Force, where the amount of the credit received by an Air Force unit turning in an item is determined by the need for the item at the wholesale level. The GAO pointed out that, in the Air Force, if it is not needed, no credit is given to the unit. (pp. 5-8/GAO Draft Report)

DOD RESPONSE: Partially concur. The DoD agrees that the buying power of the operation and maintenance units is increased when credit is granted. A mix of credit and operation and maintenance funding is used in determining how many operating tempo dollars the units receive. The use of credit by the Army in determining unit operating tempo is designed to reduce the request for appropriated operation and maintenance funds.

The credit rates that the retail stock fund uses to grant cooperation and maintenance customers credit is based on historical data. With the unprecedented amount of returns from stock fund depot level reparable, Gulf War residual, and downsizing, adjustments of the credit rates at the retail stock fund were required. However, a budget lead time is required to adjust the rates. As noted in the GAO report, the credit rates were reduced from 54 percent in FY 1993, to 52 percent in FY 1994, and to 47 percent in FY 1995.

The U.S. Forces Command accounts for 90 percent of the \$201 million imbalance. The Army Audit Agency has been directed to review the U.S. Forces Command procedures at some of its installations to identify any process problems that may be creating short-term imbalances (i.e., backlog of unserviceables at the installation level, report delays to wholesale, transportation bottle necks, and automation shortfalls.) Part of the \$201 million imbalance can be attributed to the timing difference of the credit granted from the wholesale and the retail levels. The Army Audit Agency will also look at delays in shipping the returns from the installation to the wholesale level, which contributes to the imbalance. The credit the retail stock fund receives from wholesale is between 50-70 percent of the standard price, based on surcharges, repair costs, and washout factors. The higher credit rate offsets the noncredit transactions.

The draft report listing of credits awarded for returned items by Army Major Command is incorrect. The Army Training and Doctrine Command actually received \$15 million more for wholesale credits than listed by the GAO.

Now on pp. 5-7.

The GAO expressed their inability to capture significant comparative data on the Air Force's implementation in Appendix I (Air Force data is not available, maintained or trackable) of the draft report. Therefore, references to Air Force's credit practices are inapplicable to this audit and should be omitted.

- **FINDING D: Installations Are Repairing Items That Are In Long Supply at the Wholesale Level.** The GAO concluded Army units were spending operation and maintenance funds to repair items at the retail level that are in long supply at the wholesale level. The GAO explained that, if a unit ordered a replacement item from the wholesale level and turned in an unserviceable item, the unit would have to pay the repair cost and a surcharge equal to about 19 percent of the acquisition price. The GAO further explained that, if the unit repaired the item locally, the surcharge would be avoided. The GAO concluded that, from an individual unit perspective, it is cheaper to repair the item locally than to buy it from the wholesale level. The GAO further concluded, however, that from an Army-wide perspective, it was not prudent management to spend operation and maintenance resources when there are unneeded items at the wholesale level. (pp. 8-9/GAO Draft Report)

DOD RESPONSE: Partially concur. The DoD does not agree it is imprudent management to spend operations and maintenance resources when there are items in long supply at the wholesale level. Factors such as transportation or the low cost to repair in relation to acquisition must be considered in the decision to repair an item. When local repair occurs for depot level reparable items, it is normally limited, less complex, and cheaper than depot level repair. Encouraging increased authorized local diagnosis and repair is, in fact, one of the desired outcomes of stock funding depot level reparables. Wholesale requirements and asset levels continually change, causing items frequently to migrate to and from long supply levels. Sometimes, it is prudent and desired management to spend operations and maintenance resources for local repair of items when they are in long supply (needed, but not immediately) at the wholesale level. When local repair cost is significantly less than depot level repair, and the unserviceable asset is retained at the wholesale level against a retention requirement (long supply, but not excess), it is usually more cost effective to perform the repair locally.

- **FINDING E: Army Initiatives to Address the Problem.** The GAO outlined the following several initiatives the Army is testing to address eliminating the disparity between the amount of credits at the retail and wholesale levels given to units and the problem of units repairing items that are in long supply and being disposed of at the wholesale level:

- Eliminating the disparity between credits at the retail and wholesale levels--The GAO reported that the Army plans to test a single stock fund initiative in June 1994, which would do away with the retail stock fund and extend ownership, control, and visibility of installation stocks to the wholesale system. The GAO concluded that, with only one stock fund (as compared to the two funds that currently exist), the problem of the retail stock fund giving more credit to units turning in items than it receives from the wholesale stock fund would disappear.

The GAO referenced a 1990 report (OSD Case 8159) and a 1991 report (OSD Case 8701), in which it recommended that the Army adopt a single stock fund to improve the management of the Army inventory system. The GAO asserted that, because of the problems and delays with the single stock fund test and the concerns about implementation of a single stock fund, it is uncertain whether the Army will resolve the single stock fund issue. The GAO concluded that, if changes are not made, an imbalance between the amount of credit given by the retail stock fund to operation and maintenance customers and the amount of credit given to the retail stock fund by the wholesale stock fund would continue.

- The Army will reduce the price of items in long supply. The GAO also reported the Army is currently offering selected items to units at a reduced price--units that are in long supply at the wholesale level. The GAO observed that the Army had identified 122 items to be included in the reduced price program. The GAO concluded that, if the Army wants to reduce its long supply assets at the wholesale level and encourage units not to repair those items, then the list of long supply assets offered at a reduced price should be increased.
- A new maintenance concept to address local repair of long supply items. The GAO reported that, in addition, the Army began a proof of principle test in November 1993 on a new maintenance concept--i.e., integrated sustained maintenance--that would place all maintenance resources above the direct support level under the control of the wholesale level maintenance manager, the Army Materiel Command. The GAO noted that, under the concept, the wholesale level maintenance manager would manage the general support and depot maintenance facilities based on Army-wide maintenance needs. The GAO observed that the integrated sustainment maintenance concept being tested is a modified version of the initial program. The GAO further observed that the test is being conducted on a regional basis, with the Corps Support Command acting as the regional maintenance manager.

The GAO asserted that a national maintenance manager is in the best position to determine, from an Army-wide perspective, what items should be repaired and to ensure that items in long supply are not repaired. The GAO concluded that, if the Army decides to implement integrated sustainment maintenance using a national maintenance manager, the question arises as to whether additional testing would be required since the proof of principle test was conducted using a regional version of the maintenance concept. (pp. 9-13/GAO Draft Report)

low on pp. 8-11.

DOD RESPONSE: Partially concur. The DoD agrees with the general description of the Army initiatives. In several instances, however, the scope and intent of the initiatives are broader than the GAO described.

The single stock fund initiative was developed to provide better visibility of assets at the installation level, promote the use of those assets to offset requirements and reduce procurements--and, if possible, eliminate some operating systems by standardizing business processes. The initiative was not developed to eliminate the disparity between wholesale and retail credit rates. Elimination of the disparity between wholesale and retail credit rates is an additional benefit of the initiative. The single stock fund initiative is scheduled to begin a full-scale proof-of-principal test in June 1994, at Fort Hood, Texas.

Revisions to the credit rate were completed on October 1, 1993. Additional revisions incorporated in the FY 1995 operating tempo rates will be effective October 1, 1994. Further, the Army received only 50 percent of its requested withdrawal credits (\$325 million of the \$650 million requested) to pay for open operation and maintenance customer backorders at the time of implementation of Defense Management Review Decision 904. The reasoning was that credits for turn-in of excess field items would offset the remainder of the requirement. The increased operating and maintenance buying power of the credit imbalance was an offset to the underfunding of valid requirements.

The purpose of the Army reduced pricing initiative is to maximize field Army operations and maintenance dollars, while drawing down the inventory of long supply items. The GAO report accurately discusses the reduce price initiative, but does not address the fact that (1) it was a test that was initiated in July 1993, with a start date of January 1, 1994, (2) if successful, the test would be expanded in FY 1995, and (3) major changes to coding, automated records, and processes were required to ensure credits were suppressed, unserviceable items were disposed of, and repair programs at the installation and Major Command level were reviewed and terminated. Further, while the majority of reduced price initiative items are for older systems (that

are more likely to be in long supply), there are also components of front-line modernized systems, such as the M-1 Abrams main battle tank, the Bradley fighting vehicle system, the multiple launch rocket system, the Patriot missile system, and the Apache helicopter that are included in the reduced price initiative. A number of factors influence the decision to reduce prices on long supply items. Included in these factors are the fluid nature of long supply (i.e., an item in long supply today may be required for issue tomorrow), the solvency of the revolving fund, and the DoD policy decision to recover full costs.

Finally, the GAO table of items being repaired at Fort Hood, Texas, that were in long supply at the wholesale level incorrectly lists 333 M-88 engines in long supply. Actually, there are 45 M-88 engines in long supply.

* * * * *

RECOMMENDATIONS

- **RECOMMENDATION 1:** The GAO recommended that the Secretary of the Army revise the credit rate for the items turned in by units so that the amount of credit received by the units is linked to the amount of credit given by the wholesale system. (p. 13/GAO Draft Report)

DOD RESPONSE: Concur. The Army has several initiatives underway to align the credit received by the units to the amount of credit given by the wholesale system. The primary initiative is the revision of the credit rates from 54 percent in FY 1993, to 47 percent in FY 1995. A concurrent initiative, which reinforces the objectives of the revised credit rate, is the implementation of the reduced price initiative. That initiative blocks credit on selected long supply items, without penalizing the operating tempo of the field Army. Those initiatives, coupled with corrections of process errors at installations, have already brought the credit rates into relative balance. Also, the natural reduction of credits associated with the end of large-scale turn-in of excesses during the implementation phases of stock fund depot level reparable, and a steady state return rate, will address and resolve the credit imbalance issue in FY 1994-1995.

- **RECOMMENDATION 2:** The GAO recommended that the Secretary of the Army expand the number of long supply items being offered at a reduced price--not just those items for the older systems that do not have a projected procurement--to encourage the units to buy the items, rather than repair

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them at the local level. The GAO further recommended that the reduced price to the units should be less than the repair cost at the local level. The GAO observed that otherwise, the units will continue to repair the items locally. (pp. 13-14/GAO Draft Report)

DOD RESPONSE: Concur. The Army is expanding the number of items included in the reduced price initiative. New items will be included after a comprehensive, item-by-item analysis, considering such factors as the fluid nature of long supply and the DoD policy decision to recover full costs. Such scrutiny is necessary to assure that the reduced price initiative does not effect the solvency of the stock fund. Representatives from all Army inventory control points met April 21, 1994, and finalized plans to continue the current test and expand the program in FY 1995. It is planned that an additional 200 items will be included in the FY 1995 expansion. The current plan calls for final submission of suggested items for inclusion in June 1994, with approval in July 1994, and implementation by January 1, 1995.

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