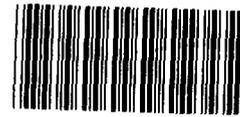


GAO

Testimony



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Defense Logistics Agency
Customers Order Supplies
Uneconomically

Statement of
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Before the
Subcommittee on Oversight of
Government Management
Committee on Governmental Affairs
United States Senate



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our report titled Defense Logistics Agency Customers Order Supplies Uneconomically.

We analyzed the approximately 17 million customer orders for supplies that DLA filled from its inventories during fiscal year 1989. We wanted to find out how much it cost DLA to fill multiple orders for very low cost items and how often customers were ordering the same supply items two or more times on the same day.

We found that customers needlessly placed small orders for supplies and multiple orders for the same supplies on the same day.

Frequently, it cost DLA more to fill these orders than the value of the supplies provided. Although customers traditionally have not paid the costs of processing and filling their orders, in 1990 DOD began requiring DLA to recover these costs through a surcharge. We recommended an alternative to DOD's approach that we believe provides better incentive to customers to use efficient ordering methods.

DLA INCURS UNNECESSARY COSTS

TO FILL LOW VALUE ORDERS

Of the 17 million customer orders that DLA filled during fiscal year 1989 (excluding fuels and subsistence), about one-third (at least 5.7 million orders) were valued at \$11 or less. Eleven

dollars is the average cost to process and fill (pick, pack, and prepare inventory items for shipping) orders for small items such as nuts, washers, screws, batteries, electrical fuses, and shampoo. Large supply items and bulk shipments cost more. Using this \$11 processing cost estimate, we calculated that DLA spent about \$63 million more than the \$22.6 million it charged its customers to fill the low-value orders.

Many of these low-value orders were for a single item. For example, of the nearly 1.3 million orders with a total value of \$.01 to \$1.00, about 40 percent (515,000) were for a single item. Our report provides examples of some of these orders, all of which were given high priority, including the following:

- A Foreign Military Sales customer in the Middle East ordered one AAA-size battery valued at \$.13,
- An Air Force contractor in Colorado ordered one AA-size battery valued at \$.10,
- An Air Force hospital in New Mexico ordered one bottle of medicated shampoo valued at \$.66,
- An Army maintenance activity in Germany ordered one 2.5-inch nylon strap valued at \$.01, and

-- A Navy ship ordered one steel lock washer valued at \$.01.

DLA fills customers' low-value orders because it views itself as a service organization whose mission is to provide whatever its customers want, whether or not it is economical to do so. Moreover, DLA has an incentive to fill such orders because it is measured on its ability to fill them.

MULTIPLE ORDERS INCREASE

SUPPLY OPERATIONS COSTS

In over 755,000 instances (involving over 1.8 million customer orders) the same customer ordered the same item more than once on the same day. If these customers had consolidated their multiple orders into one order, DLA's operations cost would have decreased by nearly \$12.1 million. Our report provides examples of these multiple orders and their potential impact on DLA's operations costs, which include the following:

-- The U.S. Army Tank Automotive Command, Warren, Michigan, placed 76 orders for 15-amp. fuse cartridges costing \$.10 each on January 24, 1989. Of these orders, 74 requested 5 fuses and 2 requested 10 fuses. At the estimated processing cost of \$11 per order, DLA spent \$836 to provide the Army with \$39 worth of fuses. If the customer had consolidated its requirement for 15-amp. fuses and placed only

one order on January 24, 1989, for 390 fuses, DLA's estimated processing cost would have been reduced by \$825, or 99 percent.

-- The Air Force Aerospace Guidance and Metrology Center, Newark Air Force Base, Ohio, placed 20 orders on July 17, 1989, for transistors costing \$2.73 each. Of these 20 orders, 15 requested 1 transistor, 4 requested 2 transistors, and 1 requested 20 transistors. At an estimated processing cost of \$11 per order, it cost DLA \$220 to fill these 20 orders. If the customer had placed only one order for 43 transistors on July 17, 1989, DLA's estimated processing cost would have been reduced by \$209, or 95 percent.

-- The U.S. Marine Corps Blount Island Command, Jacksonville, Florida, placed 36, 26, and 20 individual orders for one 8-ounce oil can priced at \$1.27 each on 3 separate days in August, 1989. At an estimated processing cost of \$11 for each order, DLA spent \$902 to provide the 82 cans. If the customer had consolidated its daily requirements and submitted one order each day, DLA's estimated processing cost would have been reduced by \$869, or 96 percent.

-- The Naval Aviation Depot in Pensacola, Florida, submitted 23, 63, and 19 individual orders for cam collars priced at \$3.34 each on 3 consecutive days in October 1988. At an estimated processing cost of \$11 per order, DLA spent \$1,155 to fill the

105 orders. If the customer had submitted a consolidated order each day, DLA's estimated processing cost would have been reduced by \$1,122 or 97 percent.

We interviewed DLA customers at 11 locations to determine why they placed multiple orders for the same item on a single day.

Generally, these customers stated that using separate orders allowed them better control and accountability over normal supply operations or special projects. For example, officials at the Marine Corps Blount Island Command said they had submitted 82 separate orders for oil cans so they could track them to 82 specific vehicles.

DOD ACTIONS

To make supply agencies and their customers more conscious of total supply costs and to encourage them to make more efficient supply decisions, DOD directed that supply organizations, including DLA, recover the full cost of their operations from customers. Thus, beginning October 1, 1990, a surcharge was added to each customer order based on a percentage of the total value of the items purchased. While we agree that full costs should be recovered, this type of surcharge, alone, will not encourage customers to consolidate their orders. Because the surcharge is a percentage of the value of the item requisitioned, DLA will charge customers the same regardless of the number of requisitions they submit for the

item. For example, a customer placing 100 individual orders for the same \$1 electronic supply item would pay a 44.2 percent surcharge, or \$44.20, on each order. However, a customer placing only one order for 100 of the same items would also pay a 44.2 percent surcharge, or \$44.20. Consequently, while DLA may recover its full costs of supply operations, customers have no incentive to change their ordering methods. Also, because its primary emphasis is to fill customer orders, DLA will have little incentive to change the methods that customers use to order supplies.

We recommend, instead, that DOD levy a minimum charge per order sufficient to recover the full cost of filling the order.

Establishing this charge would not only allow DLA to recover its full costs but would also encourage customers to submit fewer low-value orders and eliminate multiple orders for the same item on the same day.

In commenting on our report, DOD stated that our recommendation would not be equitable, since it would penalize some supply system customers. Our recommendation is not intended to penalize customers, but to ensure that customers pay the costs of filling the orders they submit. We believe our recommendation allows the customer to decide if ordering items separately to maintain control, for example, is worth the additional costs incurred.

To date, DOD has directed DLA to implement surcharges to recover full costs and is now identifying and evaluating other alternatives.

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Mr. Chairman, that concludes my prepared statement. We will be happy to respond to any questions.

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EXHIBITS TO BE DISCUSSED
DURING THE TESTIMONY

CUSTOMER ORDERS FILLED BY DLA
DURING FISCAL YEAR 1989

<u>Value of orders</u>	<u>Number of orders</u>	<u>Percent</u>
\$.01 - 1.00	1,270,354	7
1.01 - 5.00	2,505,721	15
5.01 - 11.00	1,940,572	12
11.01 - 20.00	1,730,688	10
20.01 - 30.00	1,227,611	7
30.01 - 100.00	3,590,811	21
Over 100.00	<u>4,744,873</u>	<u>28</u>
Total	<u>17,010,630</u>	<u>100</u>

DAILY MULTIPLE ORDERS FILLED
FOR THE SAME ITEM AND CUSTOMER
DURING FISCAL YEAR 1989

<u>Number of repeated orders (daily)</u>	<u>Instances</u>	
	<u>Number</u>	<u>Percent</u>
2	589,065	78.0
3	96,373	12.8
4	35,219	4.7
5	14,453	1.9
6	6,786	0.9
7	3,578	0.5
8	2,404	0.3
9	1,792	0.2
10 and over	<u>5,126</u>	<u>0.7</u>
Total	<u>754,796</u>	<u>100.0</u>

EXAMPLES OF ONE-ITEM ORDERS

GIVEN A HIGH PRIORITY

<u>Item</u>	<u>Value</u>
AAA-size battery	\$ 0.13
AA-size battery	0.10
4-ounce bottle of shampoo	0.66
2.5-inch nylon strap	0.01
Steel lock washer	0.01

EXAMPLES OF POTENTIAL SAVINGS FROM
DAILY CONSOLIDATION OF CUSTOMER ORDERS

<u>Item</u>	<u>Number of orders</u>	<u>Estimated processing cost</u>	<u>If consolidated.</u>	
			<u>Potential processing cost</u>	<u>Potential savings</u>
15-Amp fuse cartridge	76	\$ 836.00	\$ 11.00	\$ 825.00
Transistor	20	220.00	11.00	209.00
8-ounce oil can	82	902.00	33.00	869.00
Cam collar	105	1,155.00	33.00	1,122.00

COMPARISON OF GAO PROPOSAL AND DOD PROCESSING CHARGES
FOR CUSTOMER ORDERS

<u>Item</u>	<u>Unit cost</u>	<u>Estimated processing cost for each order</u>	
		<u>DOD surcharge¹</u>	<u>GAO proposal²</u>
2.5-inch nylon strap	\$ 0.01	\$ 0.00	\$ 11.00
AA-size battery	0.10	0.04	11.00
AAA-size battery	0.13	0.06	11.00
4-ounce bottle of shampoo	0.66	0.13	11.00
Engine radiator	382.22	153.27	38.22
Compressor	7,300.00	2,927.30	730.00

¹ DOD's directed method recovers processing costs through a surcharge added to the standard unit cost of each supply item. The surcharge used is determined by commodity; 19.3 percent-medical; 20.8 percent-clothing and textiles; 31.2 percent-general; 40.1 percent-construction; 44.2 percent-electronics; and 48.8 percent-industrial.

² GAO's proposal is to levy a minimum charge on each order when the DLA surcharge to recover wholesale losses, retail losses, transportation, inflation, and stabilization costs is not sufficient to recover the cost to process and fill the order. These surcharges by commodity were 9.5 percent-medical; 12.2 percent-clothing and textiles; 14.8 percent-general; 10.0 percent-construction; 15.8 percent-electronics; and 15.4 percent-industrial.