



United States
General Accounting Office
Washington, D.C. 20548

151416

**National Security and
International Affairs Division**

B-256795

April 22, 1994

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

Dear Mr. Chairman:

As part of our ongoing efforts to monitor and evaluate the Department of Defense's (DOD) progress in implementing the Defense Business Operations Fund (DBOF), we assessed the impact of DBOF at selected military installations. Our specific objectives were to (1) determine what impact the Fund has had at the customer and provider level and (2) identify problems managers at this level were having with DBOF implementation. Because of your interest in DBOF issues, you asked that we summarize and report the results of our work. This correspondence responds to your request.

BACKGROUND

On October 1, 1991, DOD consolidated nine industrial and stock funds into a single revolving fund called DBOF.¹ At that time, DOD said that DBOF would improve cost awareness within the Department and give managers more flexibility in making business decisions. Under this concept, the industrial and stock fund managers (providers) would identify and charge military customers the full cost of providing goods and services. While the providers always charged customers for the cost of doing business, some of these costs have traditionally been funded through direct appropriations and not passed on to customers.

¹DBOF also includes the following defense agencies businesses: Defense Finance and Accounting Service, Defense Commissary Agency, Defense Technical Information Center, Defense Reutilization and Marketing Service, and Defense Industrial Plant Equipment Center.

In theory, this change would encourage providers to control costs and promote efficiencies within their business areas-- in other words, provide better service to customers at reduced costs. Customers, in turn, would become more efficient in their procurement practices because they would now pay the full cost for the goods and services they purchased--they would be less inclined to purchase unneeded goods and services. The underlying concept of the DBOF, therefore, is that customer/provider procedures would more closely model those used by private businesses in the general economy.

RESULTS IN BRIEF

We have previously reported that DBOF has not had its intended impact on industrial and stock fund operations. We found the same to be true during this review. More specifically, the customer- and provider-level managers we contacted told us that DBOF has not resulted in any significant change in operations. Many of these managers were generally uninformed, confused, and in some cases, antagonistic about DBOF implementation. Overall, there was a general lack of understanding about the DBOF basic concept.

DBOF IMPLEMENTATION HAS HAD MINIMAL IMPACT AT THE CUSTOMER/PROVIDER LEVEL

Military industrial and stock fund managers told us the establishment of DBOF does not change any previous organizational reporting structure or command authority relationship. They stated that since functional and cost management responsibilities remained with the service headquarters and defense agencies, any changes due to DBOF are virtually transparent at the customer/provider level. Even though DOD has issued new policies and guidance in several areas (e.g., capital asset management, revenue recognition), we were told that each military service continues to operate its individual stock and industrial funds in much the same manner as before DBOF implementation. The primary exception is that the management of cash is now consolidated at the Office of the Secretary Defense level. Prior to DBOF, each service had cash management responsibility for their industrial and stock funds.

Managers at the provider level said they were aware of their costs of providing goods or services to customers but said the rates were adjusted at higher DOD levels to cover other indirect costs or expected operating losses. While this was also the case prior to DBOF, the rates are now adjusted to

reflect what DOD believes is the full cost of operations. The managers at the provider level said they have not been given any additional visibility over these costs. They stated this impacts on their ability to explain to customers the total cost of providing goods and services.

It is also worth noting that some of the activities we visited were unable to provide us with a list of their specific customers. They asked us to contact the Defense Finance and Accounting Service, which does the billing for the activities, to get a customer list. In our view, it is important for providers to know their customers well in order to effectively implement DBOF. Such knowledge, for example, allows providers to focus on their customers' specific needs and determine how to provide them with better products and service.

In this respect, the customers we contacted have not seen any improvement in the quality of goods or service as a result of DBOF implementation. While some customers said they have seen an increase in the cost of goods and services, they did not know whether the increase was related to DBOF or some other DOD initiative. In addition, customers told us that even if they are dissatisfied with the quality of goods and services, many obstacles prevent them from seeking alternative sources of supply. These include, (1) current regulations requiring them to purchase only from designated DOD supply sources, (2) additional effort and paperwork that must be filled out to justify purchases outside the normal procurement network, and (3) non-DOD approved private sector sources that generally do not manufacture products according to military specifications. While a long-term vision of DBOF was to allow customers to seek alternative sources of supply, DOD has put this initiative on hold to evaluate its implications on overall military procurement.

MANAGER'S VIEW OF PROBLEMS THAT
PREVENT FULL DBOF IMPLEMENTATION

DOD managers at the customer and provider level cited many problems with DBOF implementation, many of which are similar to areas identified in our prior work. (See the list of our related products at the end of this report.) They said, for example, that prior to DBOF implementation, DOD had not (1) developed comprehensive policies and procedures to govern the DBOF's operations, (2) developed accurate and reliable cost accounting systems to capture and report the full cost of operations, or (3) described to DBOF managers and customers precisely how the Fund would operate and how

it would be controlled. As a result, the managers said that most people were generally unaware of DBOF's goals and objectives and what, if anything, they should be doing differently to carry them out. Some viewed DBOF as merely a management initiative designed to provide better financial information and improve accounting procedures--not as something to improve the operating efficiency of DOD's industrial and stock funds. Several managers said their staff were more confused about the Fund's goals after receiving training on DBOF than before. We also found some managers who were openly antagonistic toward DBOF; they saw it as little more than a paper exercise that offered additional work but no real benefit or improvement to their operation.

These problems are consistent with many of the findings of a recent DOD analysis of DBOF implementation problems. To address these problems, in September 1993, DOD issued the "Defense Business Operations Fund Improvement Plan." This plan lays out a number of action items, including timetables, for solving the type of problems we have identified in this letter. We have just issued a report, however, that says DOD has already fallen behind on its implementation efforts.² As part of our responsibility to follow and report on DBOF implementation, we will continue to monitor DOD's progress in addressing these problems.

SCOPE AND METHODOLOGY

In doing our work, we obtained and analyzed pertinent reports and documents to determine the extent of DBOF implementation. To determine DBOF's impact at the customer/provider level, we met with and obtained information from DOD headquarters and selected major command officials. We also interviewed Army, Navy, Air Force, Defense Logistics Agency, and Defense Finance and Accounting Service customers/providers in Northern California and San Antonio, Texas. In total, we interviewed 113 DOD officials at 37 defense agencies and activities. (See attachment for a complete listing of defense agencies and activities contacted.) The activities we visited were judgementally selected and do not statistically represent all defense providers and customers.


We are sending copies of this letter to the Secretary of Defense; the Director of the Office of Management and

²Financial Management: Status of Defense Business Operations Fund (GAO/AIMD-94-80, Mar. 9, 1994).

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Budget; the Chairman of the Senate Committee on Armed Services; the Chairman of the House Committee on Armed Services; and other interested parties. Our field work was led by Cornelius P. Williams, senior evaluator. If you have any questions, please contact James E. Hatcher or me on (202) 512-8412.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Donna M. Heivilin".

Donna M. Heivilin, Director
Defense Management and NASA Issues

Enclosure

DEFENSE AGENCIES AND MILITARY
INSTALLATIONS CONTACTED

<u>Service/Defense Activity</u>	<u>Command</u>	<u>Provider</u>	<u>Customer</u>
<u>Army</u>			
Army Materiel Command Alexandria, Virginia		X	
U.S. Forces Command Fort McPherson, Georgia	X		
Fort Sam Houston San Antonio, Texas			
-- Supply Management		X	
-- Brooke Army Medical Center			X
-- 90th Army Reserve Command			X
Sacramento Army Depot Sacramento, California			
-- Maintenance Directorate		X	
<u>Navy</u>			
Naval Supply Systems Command Arlington, Virginia	X		
Fleet and Industrial Supply Center Oakland, California		X	X
-- USS Samuel Gompers			X
-- Naval Aviation Depot-Alameda			X
-- Naval Air Station-Moffett Field			X
-- Public Works Center- San Francisco Bay			
-- Shore Intermediate Maintenance Activity-San Francisco			
-- Defense Distribution Depot-Oakland		X	X
-- Naval Sea Systems Command-Oakland			X
Mare Island Naval Shipyard Vallejo, California		X	X
-- Naval Sea Systems Command			X
-- Space and Naval Warfare Systems Command		X	
-- Naval Command, Control and Ocean Surveillance Center		X	

ENCLOSURE

ENCLOSURE

<u>Service/Defense Activity</u>	<u>Command</u>	<u>Provider</u>	<u>Customer</u>
Public Works Center-San Francisco Bay		X	
-- Naval Aviation Depot-Alameda			X
-- Mare Island Naval Shipyard			X
<u>Air Force</u>			
Air Force Material Command Wright-Patterson AFB, Ohio	X		
San Antonio Air Logistics Center Kelly AFB, Texas		X	
651st Air Base Group Kelly Air Force Base, Texas		X	
Sacramento Air Logistics Center McClellan AFB, California			X
-- Commodities Directorate		X	
-- 940th Air Refueling Group			X
60th Airlift Wing Travis AFB, California		X	X
-- Defense Commissary Agency			X
-- 750th Space Group- Onizuka Air Base, California			X
-- National Aeronautics and Space Administration, Ames Research Center, Moffett Field, California			X
<u>Defense Logistics Agency</u>			
Defense Distribution Depot San Antonio, Texas		X	
<u>Defense Finance and Accounting Service</u>			
-- Mare Island Naval Shipyard		X	X
-- Fleet and Industrial Supply Center-Oakland			X

RELATED GAO PRODUCTS

Defense's Planned Implementation of the \$77 Billion Defense Business Operations Fund (GAO/T-AFMD-91-5, Apr. 30, 1991).

Financial Management: Defense Business Operations Fund Implementation Status (GAO/T-AFMD-92-8, Apr. 30, 1992).

Financial Management: Status of Defense Business Operations Fund (GAO/AFMD-92-79, June 15, 1992).

Defense Business Fund (GAO/AFMD-93-52R, Mar. 1, 1993).

Financial Management: Opportunities to Strengthen Management of the Defense Business Operations Fund (GAO/T-AFMD-93-4, May 13, 1993).

Financial Management: Opportunities to Strengthen Management of the Defense Business Operations Fund (GAO/T-AFMD-93-6, June 16, 1993).

Financial Management: Status of the Defense Business Operations Fund (GAO/AIMD-94-80, Mar. 9, 1994).

Financial Management: DOD's Efforts to Improve Operations of the Defense Business Operations Fund (GAO/T-AIMD/NSIAD-94-146, Mar. 24, 1994).

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