DEPARTMENT OF DEFENSE

AUDIT REPORT

DEFENSE LOGISTICS AGENCY
COMMERCIAL ACTIVITIES PROGRAM

No. 90-009

November 7, 1989

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

November 7, 1989

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (PRODUCTION AND LOGISTICS)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Report on the Audit of Defense Logistics Agency Commercial Activities Program (Report No. 90-009)

This is our final report on the Audit of Defense Logistics Agency Commercial Activities Program for your information and use. Comments on a draft of this report were considered in preparing the final report. We made the audit from April through October 1988 at the request of the Deputy Assistant Secretary of Defense (Installations), Office of the Assistant Secretary of Defense (Production and Logistics). The audit objective was to evaluate the Defense Logistics Agency's (DLA) implementation of Office of Management and Budget Circular A-76 (the Circular), "Performance of Commercial Activities," reissued August 4, 1983. As of September 30, 1988, DLA's reported commercial activities inventory was valued at $548 million. DLA has realized $7.9 million in reportable first year cost avoidances on completed cost studies since the Circular was revised on March 29, 1979, to give additional emphasis to studies of commercial activities.

The audit showed that DLA has not made a concerted effort to perform the studies required by the Circular. Further, DLA has not complied with the requirements of Executive Order 12615 (the Executive Order), November 19, 1987, and Section 1111 of the National Defense Authorization Act for Fiscal Years 1988 and 1989, also known as the "Nichols Amendment." The results of the audit are summarized in the following paragraph and the details, audit recommendation, and management comments are in Part II of this report.

DLA has not made a concerted effort to properly inventory its commercial activities, perform the required studies, and implement the results of the studies. Since FY 1979, DLA has completed studies on only 7 percent of its in-house commercial activities inventory. This lack of concerted effort was further evidenced by an inaccurate commercial activities inventory. As a result, DLA will not meet the 3-percent study goal set forth in the Executive Order. In addition, DLA has lost, and will continue to lose, the opportunity to achieve up to $61.5 million, during a 5-year period, in reportable first year cost avoidances

that would be obtained by performing and implementing the results of the additional studies required. We recommended that the Director, DLA, comply with the requirements of the Executive Order and the Nichols Amendment. This recommendation also stated that the Director, DLA, should, at a minimum, issue a commercial activities regulation that provides policies, procedures, and detailed guidance for computing the commercial activities inventory and that permits the installation commanders to prioritize the scheduling and studying of all commercial activities functions (page 5).

The audit identified internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Controls were not effective to ensure that DLA command personnel made a concerted effort to perform the studies required by the Circular. The Recommendation in this report, if implemented, will contribute to the correction of the weakness. We have determined that up to $61.5 million in monetary benefits can be realized by implementing the Recommendation. A copy of this report will be provided to the senior officials responsible for internal controls within the Office of the Secretary of Defense and DLA.

We provided a draft of this report to the Assistant Secretary of Defense (Production and Logistics) and to the Director, DLA, on April 3, 1989. The DLA comments, dated June 1, 1989, were provided by the Comptroller, DLA. The complete text of management comments is provided as Appendix C.

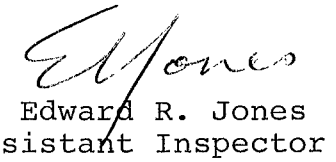
The Comptroller, DLA, nonconcurred with the finding and partially concurred with the Recommendation. In comments on the Recommendation, the Comptroller concurred that the Director, DLA, should comply with the Executive Order and the Nichols Amendment, but stated that this has been done and the audit report does not convincingly demonstrate that previous Directors have done otherwise. The Comptroller noted that additional guidance on calculating the inventory will be provided when OSD issues an addendum to DoD Instruction 4100.33, "Commercial Activities Program Procedures." With the OSD issuance of the addendum, DLA plans to issue supplemental guidance, including a method for the accurate calculation of full-time equivalent positions in the inventory. The Comptroller also stated that no additional guidance was required to give Commanders authority to prioritize and schedule studies because the Commanders have that authority under the Nichols Amendment. We do not consider the comments to be fully responsive to the intent of our Recommendation, because there has been a lack of commitment by DLA to fully comply with the Executive Order and the Nichols Amendment. We request clarification from the Director, DLA, on the Agency's commitment

to the commercial activities program and actions planned to schedule and complete timely studies of commercial activities. We also believe that DLA should issue new guidance on permitting the installation commanders to prioritize the scheduling and studying of all commercial activities functions because previous guidance limited the authority of the installation commanders. Accordingly, we believe the Recommendation is still valid and request that the Director, DLA, provide comments in response to the final report.

The Comptroller, DLA, did not agree with the annual potential monetary benefits of $66 million shown in our draft report. We computed the amount of the benefits based on our calculation of DLA cumulative cost avoidances of $33 million achieved since the Circular was revised on March 20, 1979. The Comptroller agreed with the reasonableness of the potential monetary benefits as a straight-line projection, however, he stated that cost avoidances actually realized could vary significantly from the DoD IG estimate. The Comptroller stated that actual cost avoidances are determined through a complex interplay of many factors, such as the total costs of compensation and equipment for a function, offset by efficiencies realized by modernization efforts and separate management initiatives, and the type and quality of bidders responding to the solicitations. We agree that actual cost avoidances could vary as determined by implementation of the necessary studies and management actions. Further, we have revised our calculation of annual potential monetary benefits based on the Defense Manpower Data Center's (DMDC) reporting procedures. Instead of reporting total cost avoidances over the length of the cost comparison period, we have used the DMDC procedure of annualizing the contract or in-house costs and reporting only the cost avoidance achieved in the first year of operation. Accordingly, the amount of the annual potential monetary benefits is $12.3 million with a claimed cost avoidance of up to $61.5 million during a 5-year period. We ask that management provide final comments on the estimated monetary benefits of $61.5 million identified in Appendix E. Potential monetary benefits are subject to mediation in the event of nonconcurrence or failure to comment.

DoD Directive 7650.3 requires that all audit recommendations be resolved within 6 months of the date of the final report. Accordingly, final comments on unresolved issues in this report should be provided within 60 days of the date of this memorandum.

The courtesies and cooperation extended to the staff during the audit are appreciated. If you have any questions on this report, please contact Mr. Allen Wyllie at (202) 694-8231 (AUTOVON 224-8231). A list of audit team members is in Appendix G. This report is being distributed to the activities listed in Appendix H.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force

REPORT ON THE AUDIT OF DEFENSE LOGISTICS AGENCY
COMMERCIAL ACTIVITIES PROGRAM

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Prepared by:
Logistics Support
Directorate
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REPORT ON THE AUDIT OF DEFENSE LOGISTICS AGENCY COMMERCIAL ACTIVITIES PROGRAM

PART I - INTRODUCTION

Background

Office of Management and Budget (OMB) Circular A-76 (the Circular), "Performance of Commercial Activities," reissued August 4, 1983, requires the Federal Government to rely on commercial sources to provide commercial products or services if they can be procured more economically from a commercial source. The Commercial Activities Program (the Program) involves a determination of which activities should be classified and reported as commercial activities' functions, the review of commercial activities' functions for exemption from study, and a cost comparison study of all nonexempt commercial activities' functions to determine whether the function should be retained in-house or contracted out. Factors affecting the history of the Program include a 1979 revision of the Circular placing renewed emphasis on a specific format for preparing cost comparisons, a 1980 congressional moratorium, a resurgence of the Program in 1981, and the reissuance of the Circular on August 4, 1983.

DoD procedures for implementation of the Circular are outlined in DoD Directive 4100.15, "Commercial Activities Program," August 12, 1985, and DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 9, 1985. Defense Logistics Agency (DLA) procedures are contained in Commercial Activities Program Letter (CAPLTR) 5-82, "Defense Logistics Agency Guidance for Commercial Activities Program," October 1982 (revised February 1983) and in subsequent CAPLTR's.

Executive Order 12615 (the Executive Order), "Performance of Commercial Activities," November 19, 1987, stressed the value of the Program to the nation and challenged Federal agencies to increase their efforts in the Program. The Executive Order also set study goals for all executive departments and agencies. Beginning in FY 1989, each executive department or agency must conduct studies of not less than 3 percent of its total civilian work force each year, until all identified potential commercial activities have been studied.

Section 1111 of Public Law 100-180, the National Defense Authorization Act for Fiscal Years 1988 and 1989, (an amendment sponsored by the late Congressman William Nichols and known as the "Nichols Amendment") provides that commanders of military installations be given authority and responsibility over local commercial activities' programs. The commanders are required to prepare an inventory of commercial activities that Government personnel can review each fiscal year; to decide which commercial activities would be reviewed under the procedures and requirements of the Circular; to conduct a solicitation for those

commercial activities selected for possible conversion to contractor performance; and to assist in finding suitable employment for any Government employee displaced because of a contracting-out decision.

The Secretary of Defense issued guidance in February 1988 encouraging the Military Departments and the Defense agencies to implement the goals of the Executive Order and the Nichols Amendment. In addition, the Secretary of Defense established for DLA a FY 1988 goal to review 1,350 full-time equivalent (FTE) positions. In the April 22, 1988, response to the Secretary of Defense, the Director, DLA, indicated that due to the amount of time needed to complete the study process only 20 percent (277 FTE's) of the study goal will be completed by the end of FY 1988.

This audit was initiated in response to a September 23, 1987, request from the Deputy Assistant Secretary of Defense (Installations), Office of the Assistant Secretary of Defense (Production and Logistics). The Deputy Assistant Secretary requested that we evaluate DLA's Commercial Activities Program because the "DLA has experienced difficulty in their implementation of the Commercial Activities (A-76) Program in both completing studies and in executing study results."

Overall, DLA's Program included personnel costs valued at approximately $548 million in the inventory reported as of September 30, 1988. This inventory consisted of 16,056 FTE positions, valued at $503 million, and 1,167 service contract FTE positions, valued at $45 million. Since the Program was revised on March 29, 1979, DLA has realized approximately $7.9 million in reportable first year cost avoidances through implementation of 20 completed cost studies.

Objective and Scope

The primary objective of the audit was to evaluate DLA's implementation of the Circular. We discussed the overall Program with the late Congressman William Nichols and his staff and with personnel from OMB, the Office of the Assistant Secretary of Defense (Production and Logistics), the Military Departments' Headquarters, and the DLA activities visited. Although the Program is Federal Government-wide, this audit encompassed only the Program at DLA. DLA has a total of 25 primary level field installations that are categorized as supply centers, service centers, depots, and contract administration services regions. We statistically selected nine installations (two supply centers, three service centers, two depots, and two contract administration services regions) for audit purposes (see Appendix A). Our evaluation included the analysis of records dated from October 1979 through October 1988 related to the

commercial activities' classification decision, exemption review, and cost comparison study processes both at Headquarters, DLA, and at the nine installations visited.

This program results audit was made from April through October 1988 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. Activities visited or contacted during the audit are shown in Appendix F.

Prior Audit Coverage

The DoD Inspector General Report No. 83-085, "Department of Defense Implementation of the Commercial Activities Program," March 9, 1983, reported on the validity, accuracy, and completeness of the annual commercial activities inventory compilations. The report also discussed a lack of required approvals and documented justifications for exemptions from the Circular cost comparison process. The audit report further detailed inaccuracies in the dollar amounts used in cost comparison decisions.

The audit report recommended:

- that all commercial activities, regardless of their potential contractability, be included in the commercial activities inventories,

- that required approvals be obtained and justifications for exemptions of commercial activities from the Circular cost comparison process be documented, and

- that cost advantages of cost comparison decisions be reported in accordance with the procedures prescribed by OMB and DoD regulations.

The second recommendation was the only recommendation directed to DLA. DLA stated that it already complied with the requirements for exemptions and that supporting documentation is available.

The DoD Inspector General Report No. 88-099, "Report on the Audit of the Defense Logistics Agency Decision to Retain Industrial Plant Equipment Operations In-House," March 10, 1988, reported on actions indicating that officials were not fair and objective in making the decision to retain the operations in-house. These actions included selecting members for the technical evaluation board who had a personal interest in the results of the commercial activities review; not providing, on all occasions, clear explanations to contractors for denying contractor's requests for information; and carrying out plans to resolicit some or all of the industrial plant equipment functions, despite a study performed by DLA that had three options for using the existing objective solicitation.

The audit report recommended that the Director, DLA, immediately perform a new commercial activities study and resolicitation of the industrial plant equipment functions to ensure equitable treatment of all contractors. In addition, the report recommended that personnel selected to evaluate the proposals be individuals not adversely affected by the outcome; and that those involved in the previous solicitation be prohibited from working on the resolicitation. The report also recommended establishing procedures that will require the servicing personnel office to certify that board members would not be adversely affected by the board's decision and that all requests for relevant information by contractors be objectively answered and documented.

Although DLA partially concurred with the finding and recommendations, DLA stated that it found no internal control deficiencies. At the same time, DLA acknowledged that it permitted personnel to participate in the study whose jobs would have been abolished had the functions been contracted out. In response to the first recommendation, DLA stated that a study would be performed.

During our current audit, we determined that DLA had not performed the recommended study. Previously, in FY 1985, DLA had recommended that these functions be exempted from study as core logistics activities, but they were not included in Public Law 99-145, "DoD Authorization Act, Section 1231, Contracting-Out for Performance of Certain Functions." However, as a result of an additional DLA request on August 16, 1988, OSD exempted the functions from study on September 29, 1988, for reasons of national defense.

PART II - FINDING AND RECOMMENDATION

Commercial Activities Program Implementation

FINDING

The Defense Logistics Agency (DLA) has not made a concerted effort to perform studies set forth in Office of Management and Budget Circular A-76 (the Circular). Since FY 1979, DLA has completed studies on only 7 percent of its in-house commercial activities inventory, and based on study deferral actions, major functional areas will not be studied. In addition, DLA's commercial activities inventory was inaccurate. We attributed these conditions to DLA's noncompliance with the requirements of the Circular, Executive Order 12615 (the Executive Order), "Performance of Commercial Activities," November 19, 1987, and Section 1111 of Public Law 100-180, the National Defense Authorization Act for Fiscal Years 1988 and 1989 (an amendment sponsored by the late Congressman William Nichols and known as the "Nichols Amendment"). As a result of DLA's delay in completing ongoing studies and deferral of planned studies, DLA will not meet the 3-percent study goal set forth in the Executive Order. Further, DLA lost, and will continue to lose, the opportunity to achieve up to $61.5 million, during a 5-year period, in cost avoidances that could be obtained by performing those studies. These cost avoidances can be achieved by reducing the cost of operating commercial activities through implementing efficient in-house organizations, or by contracting out.

DISCUSSION OF DETAILS

Background. A DoD Component's commercial activities inventory is used to assess its implementation of the Circular. The inventory must be updated at least annually to reflect changes to the Component's review schedule and the results of reviews, cost comparisons, and direct conversions. Updated inventories must be submitted to the Assistant Secretary of Defense (Production and Logistics) within 90 days after the end of each fiscal year.

DoD Instruction 4100.33, "Commercial Activities Program Procedures," September 9, 1985, outlines the Commercial Activities Program (the Program) procedures for DoD Components. The DoD Instruction requires DoD Components to determine whether cost comparisons should be conducted on existing in-house commercial activities in accordance with their established review schedules. Commercial activities can be retained in-house without a cost comparison only when justified for reasons of national defense, when no satisfactory commercial source is available, or when in the interest of direct patient care. When one of these three criteria cannot be justified, a full cost

comparison must be conducted. Our audit centered primarily on DLA in-house commercial activities because the process prescribed by the Circular ends when the commercial activity is contracted out.

DLA procedures are contained in Commercial Activities Program Letter (CAPLTR) 5-82, "Defense Logistics Agency Guidance for Commercial Activities Program," October 1982 (revised February 1983) and in subsequent DLA CAPLTR's. As of October 1988, the DLA CAPLTR's were not revised to reflect DoD Instruction 4100.33 guidance for determining the number of full-time equivalent (FTE) positions for the commercial activities inventory, compliance with the Executive Order, and compliance with the Nichols Amendment.

Status of Defense Logistics Agency Program Implementation. The DLA has not made a concerted effort to complete announced studies in a timely manner. Of 92 studies that it has announced since FY 1979, DLA has completed only 20 studies, covering 7 percent of its inventory. In addition, DLA canceled 45 studies, representing nearly half of the announced studies. Further, DLA has had 27 studies pending for an average of 5 years. Of the 27 pending studies, only 2 have reached the solicitation stage. Five years is an excessive amount of time based on existing DLA guidance. The DLA CAPLTR 5-82 indicates that only 14 months are required from the inititation of the study to the solicitation and subsequent conversion of the function. Subsequent guidance (August 1988) from the DLA Comptroller states that minor studies should be scheduled for completion within 18 to 20 months of the announcement. Minor studies are defined as small studies, located at a single activity with 50 or less FTE's involved. Major studies (defined as multiple or geographically dispersed functions, or large numbers of FTE's involved or where additional analysis regarding contracting strategy determinations is necessary prior to study) require a minimum of 24 to 26 months.

The length of time to perform studies increased, in part, because of delays in getting approval from the DLA Commercial Activity Program Office (DCAPO) for Performance Work Statements (PWS's). For instance, generic PWS's for 25 of the 27 pending studies have been routed back and forth between the DCAPO and the installations for over 5 years in an attempt to get approved PWS's. The DLA CAPLTR 5-82 indicates that DCAPO review and approval of PWS's should be completed in 3 months.

Compliance With the Executive Order. To improve implementation of the Program, the Executive Order requires agencies to conduct studies of not less than 3 percent of the agency's total civilian work force each year starting in FY 1989 until all potential commercial activities have been studied.

Analyses of DLA's prior and ongoing studies indicate that DLA will not comply with the Executive Order's 3-percent annual study goal during the next 5 years, because only 7 percent of the studies in the inventory have been completed over a period of 8 years. In addition, as previously discussed, the Director, DLA informed the Secretary of Defense on April 22, 1988, that DLA would only complete 277 of 1,350 FTE's established as a goal for FY 1988. As of October 1988, DLA had completed only 128 of the planned 277 FTE's. Further, as discussed later, 79 percent of its studiable commercial activities functions that had not been reviewed as of September 30, 1987, were reclassified as of September 30, 1988, so that they would not be available for review.

Compliance With the Nichols Amendment. To improve implementation of the Program at the military installation level, Congress enacted the Nichols Amendment on December 4, 1987. The Amendment delegates the authority over contracting for commercial activities to the commander of each military installation. In a memorandum dated February 29, 1988, the Secretary of Defense implemented the delegation provided by the Nichols Amendment. The memorandum stated:

> Effective immediately, the commander of each military installation under your jurisdiction shall have the authority and the responsibility to. . . . Decide which commercial activities shall be reviewed under the procedures and requirements of Office of Management and Budget Circular A-76 . . . .

DLA management took actions which prevented full implementation of the Program at the military installation level. DLA installation commanders were given the authority set forth in the Nichols Amendment and the OSD memorandum in an August 1, 1988, memorandum from the Director, DLA, Subject: "Commercial Activities (CA) Program," as follows.

> . . . Effective immediately, you are delegated the authority and responsibility to. . . . Decide which commercial activities shall be reviewed using existing DLA procedures and requirements based on Office of Management and Budget Circular A-76.

However, in the same memorandum, the Director limited the installation commanders' authority to make decisions by directing that study of the automated data processing (ADP) function, and the storage and warehousing function be deferred. These 2 functions include 9,240 FTE's. By limiting the authority of the installation commander, the Director, DLA, prevented the commanders from fully complying with the Nichols Amendment. Furthermore, having pulled back the authority of the installation

commanders, DLA Headquarters has not exercised that authority, since it has not scheduled these functions for central study.

The Comptroller, DLA, issued implementing guidance to the Director's memorandum on August 3, 1988. The implementing memorandum, Subject: "A-76 Commercial Activity Schedules," told the installation commanders exactly what commercial activities functions should be held in abeyance and how to code them. The guidance stated:

> The direct mission functions described under CA code T801 at DLA Supply Depots (storage and warehousing and its subcategories) should be coded as "Z" (held in abeyance because of direction by higher authority) . . . . Automated Data Processing (ADP) functions within OTIS [Office of Telecomunications Information Services] organizations should be coded as code "Z" (held in abeyance because of direction by higher authority) due to the DLA Logistics Systems Modernization Program.

The Comptroller stated that the change in categorization resulted from a DoD request for an inventory report, which the Office of Management and Budget was going to use to project budget revisions in anticipation of cost avoidances expected from near-term studies. In addition, the deferrals were made because major systematic changes and operational upgrades were occurring incrementally and at different installations at different times. Development of precise PWS's and accurate cost compilations would be very difficult with the occurrence of major systematic changes and operational upgrades.

The Director's and Comptroller's guidance has removed the installation commanders from some of the commercial activity decisionmaking process without some alternative plan for centrally studying these functions. For instance, the ADP functions could be held in abeyance until full implementation of the Baseline Enhancements and Logistics Systems Modernization Plan scheduled for FY 2010. Also, the storage and warehousing functions could be held in abeyance indefinitely because of the continuing implementation of new inventory management systems and the modernization of depot automation. Due to the potential long-range duration of the deferral, the "held in abeyance" coding has the same effect as an exemption.

For the fiscal year ended September 30, 1988, DLA reported 16,056 FTE's in commercial activity functions. As a direct result of guidance from the Director, DLA, and Comptroller, 9,240 FTE's (58 percent of 16,056) were reclassified to "held in abeyance" (code "Z"). As of September 30, 1988, the commercial activities inventory report prepared by the Comptroller classified a total of 12,741 FTE's (79 percent) as "held in

abeyance," as shown in Appendix B. In accordance with DoD Instruction 4100.33, the code "Z" category of inventory means that a cost comparison study is being held in abeyance because of direction from a higher authority. For example, the DoD Instruction cites a congressional moratorium as a reason for holding a study in abeyance. We do not believe that DLA Headquarters' decision to reclassify its functions to category "Z" to avoid budget revisions pending implementation of system upgrades meets the intent of the DoD Instruction, nor do we view the reclassification as being in conformance with the purpose of the Nichols Amendment.

DoD Inspector General Report No. 83-085, "Department of Defense Implementation of the Commercial Activities Program," March 9, 1983, recommended that required approvals be obtained and justifications for exempting commercial activities from the Circular cost comparisons be documented. In response to the report, DLA stated that it complied with the requirements for exemptions and that supporting documentation was available. At the time of this audit, DLA had not received an exemption for the ADP functions and DLA Supply Depots.

Accuracy of the Commercial Activities Inventory. DLA's commercial activities inventory for the fiscal year ended September 30, 1987, was inaccurate. DoD Instruction 4100.33 provides guidance for determining the number of FTE's. It states:

> For full-time and part-time positions, estimate total hours required by skill and divide by 1,744 annual available hours to determine the number of positions required. For intermittent positions to be expressed in FTEs, estimate total hours required by skill and divide by 2,015 annual available hours to determine the number of positions required.

None of the nine installations reviewed were complying with the OSD guidance. In addition, no consistent method was used by the installations to determine the number of FTE's. At one installation, FTE's for all of the functions within one office were being computed by manually counting employees from the Manpower Control Listing. That installation has reported the same data for the functions in the remaining offices each year since 1983 without verifying their accuracy. Three other installations divided total paid work hours by 2,087 annual available hours to determine the number of FTE's. This resulted in an understatement of total FTE's. For example, one installation used the factor of 2,087 in computing the number of FTE's and reported 1,372 FTE's. The installation should have used the factor of 1,744 and reported 1,642 FTE's.

The commercial activities inventory is the basis for reviewing, selecting, and announcing functions for cost comparison studies. Because the installations reported inaccurate

inventories to DLA, the resultant reports to OSD were distorted and management's ability to make proper decisions for the Program was diminished.

Lost Opportunities. There are no penalties for not conducting studies; however, the rewards from conducting them are the creation of the most efficient organization for the commercial activities and realization of cost avoidances associated with the implementation of the most efficient organization. DLA could establish a more efficient organization and achieve a potential cost avoidance of $12.3 million each year if it studied 3 percent of its inventory annually in accordance with the Executive Order. The potential cost avoidance was discussed by the Director, DLA, in his August 1, 1988, memorandum, which stated:

> The CA [Commercial Activities] program has historically provided savings of 30 percent - a record difficult to match through any other program. The threat of competition is not a pleasant consideration, but it is an effective one. With the prospect of increasing work load and decreasing funding, every belt-tightening measure must be taken.

Our computation of the $12.3 million annual cost avoidance potential is based on DLA's having achieved $7.9 million in reportable first year cost avoidances from the study of 1,138 FTE's. Based on the study of 1,138 FTE's, DLA achieved a reduction in staffing of 359 FTE's (32 percent). We determined the amount of reportable cost avoidances achieved by DLA's Commercial Activities Program as of September 30, 1988, using the Defense Manpower Data Center's (DMDC) formula. That formula defines reportable cost avoidances as the cost avoidances achieved in the first year of operation. We used the most efficient organization workyears, the baseline workyears, the contract bid, and the in-house bid for the cost avoidances calculation. We obtained this information from the Commercial Activity Management Information System report on completed studies. We then analyzed the $33 million in calculated cost avoidances achieved by DLA over the length of the cost comparison period to determine in-house and contract costs for a 12-month period. We then used the annualized costs in the DMDC formula to derive the $7.9 million in reportable cost avoidances. Three percent of the total civilian work force (1,533 positions) was determined based on DLA total civilian staffing as of September 30, 1988. The number of FTE's identified as studied in the FY 1988 inventory and the associated reportable cost avoidances were compared proportionally to the 3-percent study goal to determine the estimated annual cost avoidances of $12.3 million.

The achievability of the 3-percent study goal established by the Executive Order is highly unlikely at DLA and is made impossible by guidance and management actions that resulted in 79 percent of its commercial activities inventory being held in abeyance. By not reviewing or studying its commercial activities functions, DLA has lost the opportunity to achieve cost reductions because the performance of the studies results in cost avoidances regardless of whether a commercial activity is retained in-house or contracted out. Despite having 79 percent of its functions held in abeyance, DLA had a commercial activities staff of 12 employees until late 1988. At that time, the staff was reduced to two full-time analysts and one part-time administrative assistant.

RECOMMENDATION FOR CORRECTIVE ACTION

We recommend that the Director, Defense Logistics Agency, comply with the requirements of Executive Order 12615, "Performance of Commercial Activities," November 19, 1987, and Section 1111 of Public Law 100-180, the National Defense Authorization Act for Fiscal Years 1988 and 1989 (the Nichols Amendment). At a minimum, the Defense Logistics Agency should issue a commercial activities regulation that includes policies, procedures, and guidance for computing the Defense Logistics Agency's commercial activities inventory and that allows the installation commanders to prioritize the scheduling and studying of all functions in their commercial activities inventory.

MANAGEMENT COMMENTS

On June 1, 1989, the Comptroller, DLA, provided comments for the Director, DLA. The complete text of management comments is included as Appendix C. An extract of management comments on the finding and our responses is included as Appendix D.

The Comptroller concurred that the Director, DLA, should comply with the Executive Order and the Nichols Amendment, but stated that this has been done and the audit report does not convincingly demonstrate that previous Directors have done otherwise. The Comptroller partially concurred with the second part of the Recommendation on DLA issuance of additional Program guidance. The Comptroller noted that additional guidance on calculating the inventory will be provided when OSD issues an addendum to DoD Instruction 4100.33, "Commercial Activities Program Procedures." With the OSD issuance of the addendum, DLA will issue supplemental guidance, including a method for the accurate calculation of FTE positions in the inventory. The estimated completion date for the OSD issuance of the addendum and DLA issuance of the supplemental guidance is October 31, 1989. However, the Comptroller also stated that no additional guidance was required to give Commanders authority to prioritize and schedule studies because the Commanders have that authority under the Nichols Amendment.

The Comptroller did not agree with the annual potential monetary benefits of $66 million shown in our draft report. (We computed the amount of the benefits based on our calculation of DLA cumulative cost avoidances of $33 million achieved as the result of 20 studies.) He nonconcurred with the achievability of the estimated cost avoidances through completion of the 3-percent study goal. The Comptroller agreed with the reasonableness of the potential monetary benefits as a straight-line projection, however, he stated that cost avoidances actually realized could vary significantly from the DoD IG estimate. The Comptroller stated that actual cost reductions are determined through a complex interplay of many factors, such as the total cost of compensation and equipment for a function, offset by efficiencies realized by modernization efforts and separate management initiatives, and the type and quality of bidders responding to the solicitations. For these reasons, the Comptroller stated that the difference between Government bids and those submitted by industry is difficult to calculate in advance. Therefore, actual cost avoidances cannot be determined until the studies are performed.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The actions taken by the current Director, DLA, and previous Directors have only partially complied with the Executive Order and the Nichols Amendment. Actions taken by the Directors and subordinate levels of management have not fully endorsed the Executive Order and the Nichols Amendment by providing positive direction and guidance on Program implementation. Instead, the actions taken have hindered full compliance with those policies.

For instance, as stated in the report, the Director, DLA, provided guidance to the installation commanders on August 1, 1988, on implementing the Nichols Amendment. However, the Director's and subsequent DLA Comptroller's guidance limited the authority of the installation commanders by changing the coding for certain functions to "held in abeyance." If such action were not taken, the installation commanders were, as a general rule, required to review the function within a 5- to 8-year period. Thus, the action hindered full compliance by the installation commanders.

Previous DLA Directors and subordinate personnel have hindered full compliance with Program implementation by delaying submissions, by not providing approval actions, and by canceling previously announced studies. For instance, the Defense Depot Mechanicsburg, Pennsylvania (DDMP) had not submitted a review decision summary since March 4, 1986, and no approval action was taken on DDMP's Review Decision Summary (RDS) submitted for the Mechanized Systems Maintenance function. In addition, Headquarters, DLA, canceled previously announced studies of ADP and telecommunications functions. The rationale for the

cancellation of these studies and other ongoing studies was that the Depot Support Service functions would be consolidated into one study at each depot in the FY 1989/1990 time frame. Now, these planned studies have been deferred by the Comptroller's August 3, 1988, guidance.

Further, in regard to ADP functions, the DLA Director stated in a March 1987 memorandum that ADP studies were canceled due to the segregation of systems design and programming from operations. This included two ongoing installation level studies and another study planned for later that year. A review of the events related to ADP at the Defense Industrial Supply Center (DISC) showed delays due to waiting for a PWS prototype from Headquarters, DLA, delays pending resolution of the core logistics issue, and delays due to separation of the ADP hardware study from the ADP systems design study. Also, there were ADP study delays pending completion of the Baseline Enhancements and the Logistics Systems Modernization Plan. Later DISC received command approval to discontinue the study of ADP pending a full-scale review in FY 1989. In August 1988, the Comptroller's guidance deferred the ADP review.

In summary, the history of these and other functions indicates that DLA management did not intend to fully implement the Program. We request, in response to the final report, clarification from the Director, DLA, on the Agency's commitment to the Program and actions planned to schedule and complete studies of commercial activities in a timely manner.

Regarding the issuance of guidance to the installation commanders on prioritizing and scheduling studies, we agree with the Comptroller's comment that commanders have the authority under the Nichols Amendment. The intent of our recommendation, however, was to incorporate the August 1, 1988, implementing guidance from the Director, DLA, into the published guidance, without any limitations on authority. New guidance from the Director, DLA, is also needed since the August 3, 1988, guidance from the Comptroller limited the authority of the installation commanders. Accordingly, we request your comments on this issue in response to the final report.

Regarding potential monetary benefits, we have revised our calculation of annual cost avoidances based on DMDC reporting procedures. In addition, we agree that actual cost avoidances cannot be determined until the reviews and studies are completed. However, as stated by the Director, DLA, in an August 1, 1988, memorandum, "The CA [Commercial Activities] program has historically provided savings of 30 percent - a record difficult to match through any other program." Our projection is conservative and in line the historical cost avoidance of 30 percent. In response to the final report, we request that the current Director, DLA, provide comments on our revised estimate of potential monetary benefits.

SAMPLE DESIGN FOR SELECTION OF PRIMARY LEVEL FIELD INSTALLATIONS

The Defense Logistics Agency (DLA) has 25 primary level field installations that are categorized as supply centers, service centers, depots, and contract administration services regions. One installation, the Defense Reutilization Marketing Service (DRMS), consists of 169 defense reutilization marketing offices. Of the 25 installations, we randomly selected 2 of each type and we randomly selected 4 sites for review at DRMS. A cross section of functions was selected for review at each site based on status (completed, pending, canceled, and never reviewed) and frequency of appearance of the function at numerous sites. Fourteen additional functions at six noninstallations were not included in the random selection.

DLA Activity	Number of Installations	Sample Installations	Total Functions	Sample Functions
Defense Supply Center	6	2	148	17
Defense Service Center (including DRMS)	6	3	212	14
Defense Depot	4	2	99	17
Defense Contract Administration Services Regions	9	2	101	11
Total	25	9	560	59

DEFENSE LOGISTICS AGENCY
COMMERCIAL ACTIVITIES INVENTORY
SEPTEMBER 30, 1987, AND SEPTEMBER 30, 1988

Performance Code	Number of FTE'S 1/ FY 1987	FY 1988	Explanation of Codes Per DoDI 4100.3 2/
A	0	374	Retained in-house for national defense reasons
C	34	0	Retained in-house as essential for training
D	1,683	1,596	Unacceptable disruption of DoD program
E	0	0	No satisfactory commercial source
F	796	405	Government won cost comparison bid
G	1,716	890	Pending scheduled cost comparison decision
H	4	33	Cost comparison won by contractor
J	0	0	DoD hospital
K	3	17	Decision made to convert to contract without cost comparison
N	10,982	0	Performance never reviewed or approved
Z	1,266	12,741	Held in abeyance because of direction from higher authority (such as a congressional moratorium)
Total	16,484	16,056	

1/ Full-time equivalents

2/ Department of Defense Instruction

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY
REFER TO DLA-CI

JUN 1989

MEMORANDUM FOR THE DEPUTY INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on the Audit of Defense Logistics Agency Commercial Activities Program (Project No. 8SC-5013)

This is in response to your memorandum, 3 April 1989, requesting comments on the draft report of 8SC-5013. The enclosed remarks have been approved by Mr. William J. Cassell, Comptroller, Defense Logistics Agency.

FOR THE DIRECTOR:

2 Encl

JOHN S. GLOVER, JR.
Acting Chief
Internal Review Division
Office of Comptroller

TYPE OF REPORT: Audit DATE OF POSITION: [illegible] Jun 89

PURPOSE OF INPUT: Initial Position

AUDIT TITLE AND NO.: Draft Report on the Defense Logistics Agency Commercial Activities Program (Project 8SC-5013)

FINDING: The Defense Logistics Agency (DLA) has not made a concerted effort to perform Office of Management and Budget Circular A-76 (the Circular) studies. Since FY 1979, DLA has completed studies on only 5 percent of its in-house commercial activities inventory. In addition, DLA's commercial activities inventory is inaccurate. DLA has not adhered to the requirements of Executive Order 12615 (the Executive Order), "Performance of Commercial Activities," and Public Law 100-180, Section 1111 of the National Defense Authorization Act for Fiscal Years 1988 and 1989 (the Nichols Amendment). Despite the intent of the Nichols Amendment, the Director, DLA provided guidance directing the installation commanders to change reporting categories for commercial activities functions previously reported as "never reviewed" to "held in abeyance." Through this means, 79 percent of DLA's commercial activities inventory was exempted from the potential of being studied under the Circular program. As a result, DLA will not meet the 3-percent study goal set in the Executive Order. Further, DLA lost the opportunity, and will continue to lose the opportunity, to achieve an annual savings of approximately $66 million that could be obtained by performing the Circular studies.

Scattered throughout the Draft Report in the Discussion portion are other observations and characterizations: "Additionally, the length of time to perform studies increased ... because generic PWSs were used" (p. 11). Also the audit teams states (p. 12) "DLA had not obtained required approvals to hold the study of these functions in abeyance. Thus, DLA exempted commercial activities from study by reclassifying ... 'never reviewed' to 'held in abeyance'". On page 15 of the report, the audit team states "DLA Headquarters' decision to classify all functions never reviewed as held in abeyance is contrary to the purpose of the Nichols Amendment." Further, on page 17, the audit team states "By providing guidance contrary to establishing the most efficient organization, DLA has developed and utilized a means of circumventing the Executive Order and the Nichols Amendment." And, finally, the report states, "DLA continues to have a high level commercial activities staff of 12 employees dedicated to overseeing the possibility that, at some time in the future, DLA may start to actively study its commercial activities inventory." 6 8 8 Deleted

DLA COMMENTS: Partially concur with the finding and discussion.

Nonconcur with the statement DLA has not made a concerted effort to perform studies. DLA has established a cooperative approach to studies by dividing responsibility between installations and Headquarters. The installations have primary responsibility for performing management studies and cost compilations, and, in addition to the usual staff functions, Headquarters assists in writing PWSs and is prepared to provide on-site assistance with any aspect of a study, as requested.

The report states in the Finding that DLA has not adhered to the requirements of the Executive Order and the Nichols Amendment. This is further characterized (p. 15) as "DLA Headquarters decisions to classify all functions never reviewed as held in abeyance is contrary to the purpose of the Nichols Amendment." Again (p. 17) this statement is recast as "By providing guidance 8 Deleted

contrary to establishing the most efficient organization. DLA has developed and utilized a means of circumventing the Executive Order and the Nichols Amendment.' The Finding contains the statement to the effect that the reclassification of functions was a means whereby '..79 percent of DLA's commercial activities inventory was exempted from the potential of being studied...' Also, related to the classification of functions, the report states (p. 12) 'DLA had not obtained required approvals to hold the study of these functions in abeyance.' 9

Nonconcur with the statement 'decision to classify all functions never reviewed as held in abeyance is contrary to the purpose of the Nichols Amendment.' DLA has fully implemented both the Executive Order and the Nichols Amendment throughout the Agency. The decision to defer functions was an operational matter within the authority of the Director DLA as Head of a DoD component. Concerns arose because major systemic changes and operational upgrades are occurring in mission areas. Moreover, these events are occurring incrementally and at different installations at different times. This creates an operational climate where the development of precise PWSs and the preparation of accurate cost compilations would be very difficult. The concern was that a real probability existed of serious error if a CA study was performed during a period of substantial operational change.

Far from attempting to evade studies and circumvent the law, as is stated in the Audit Report, DLA elected to defer studies only until proper studies can be performed. The operative word here is 'defer' (suspend temporarily). The word 'exempt' (exclude permanently) is not applicable. The intention remains as it has always been to study functions when effective studies are possible

DoD approval is required and is requested for any proposed exemption, but approval is not required for deferrals, particularly when they are based upon operational considerations affecting main mission functions.

The audit report mis-identifies both the intent and the significance of the reclassification of functions. The report asserts that the result of categorizing functions from never reviewed to held in abeyance was to exempt 79 percent of the CA inventory from study. This is erroneous in several ways As previously said, the functions are deferred, not exempt. The change in categorization resulted from a DoD request for an inventory report which the Office of Management and Budget would use to project budget revisions in anticipation of savings expected from near-term CA studies. Because the deferred functions will not be studied in the near future, budget projections based upon completion of such studies would have been inaccurate. The category was, therefore, changed to avoid such errors and, incidentally, to more accurately reflect the true status of the functions. DoD guidance was to report only functions categorized as never reviewed (code N) and functions which had been won in-house during prior CA cost comparisons (code G), as a base for the OMB projections. Moreover, the reclassification did not affect the general status of the functions which were, and remain, deferred. They are in no way exempt from study and all documentation so indicates. Quite counter to the statements and characterizations in the audit report, deferrals were made in an effort to ensure effective studies and not to avoid performing the studies or to circumvent the law.

Concur with the statement that DLA will not meet the 3 percent study goal set in the Executive Order. DLA will not achieve the study goal. This goal would be difficult to achieve even without the deferrals. For instance, in FY 88, DoD studied 11,000 FTEs - the best year ever - yet the goal established by OMB for the Department for the year was 25,000 FTEs.

Nonconcur with the report that the length of time required to perform studies increased because generic PWSs prepared by DCAPO were used rather than PWSs prepared by knowledgeable people in the installations. While some studies have taken much longer than normally expected, the use of generics is not, in our view, the major, or even a significant cause. Delays are primarily the result of long review and re-drafting cycles both in the installations and Headquarters. A contributing factor is the resolution of PWS comments by correspondence. Also, changes in guidance over time can lead to revisions in language and format. And, change in assigned personnel usually slows progress for a time.

Generic PWS are basically only guidelines which quickly lose their identities as task statements are developed and written into the PWS. Even prototype PWSs require revision - sometimes extensive - from one installation to another. Moreover, all PWSs require the deep involvement of knowledgeable functional personnel.

Partially concur that DLA lost the opportunity and will continue to lose the opportunity to achieve annual savings of approximately $66 million. We agree that, within the context of the CA program, savings are not realized if studies are not performed. Therefore, clearly, DLA would realize greater savings if more and larger studies were completed.

We cannot concur with the estimated savings stated within the report to be available if the 3-percent study goal was achieved. Savings are determined, ultimately, through a complex interplay of many factors. Among these are the type of functions studied, the number of employees in the function, the total costs of compensation and equipment, and other factors. In turn, these elements may, to an unknown extent, be offset by efficiencies realized by modernization efforts and separate management initiatives. Also, a large unknown in the general cost/savings equation is the type and quality of bidder responding to the solicitations. If they are efficient, their bids can be expected to be very competitive compared to a relatively inefficient firm whose bid may be either higher or lower. For these reasons, and others, the difference between Government bids and those submitted by industry is difficult to calculate in advance.

We do not necessarily, think the DoD IG estimate is unreasonable, the method of calculation cited (p. 18) is adequate for a straight-line projection. However, savings actually realized at the 3 percent level of study could vary significantly from the DoD IG estimate. 10

Nonconcur with the statement in the report that DLA continues to have a high level CA staff of 12 employees dedicated to overseeing the possibility that at some time in the future, DLA may start to actively study its CA inventory. At the time the Audit was performed, the CA staff at Headquarters consisted of approximately 12 analysts. This staff was reallocated in late 1988 and now consists of 2 full-time analysts and one Secretary/Administrative Assistant on a part-time basis.

MONETARY BENEFITS: To be determined
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Charlie Frey, DLA-CBO

DLA APPROVAL: William J. Cassell

TYPE OF REPORT: Audit DATE OF POSITION: 1 Jun 89

PURPOSE OF INPUT: Initial Position

AUDIT REPORT AND NO : Draft Report on the Audit of Defense Logistics Agency Commercial Activities Program (Project No. 8SC-5013)

RECOMMENDATION: We recommend that the Director, Defense Logistics Agency adhere to the requirements of Executive Order 12615, 'Performance of Commercial Activities,' November 19, 1987, and the 'National Defense Authorization Act for Fiscal Years 1988 and 1989,' Public Law 100-180, Section 1111. At a minimum, the Defense Logistics Agency should issue a commercial activities regulation that includes policies, procedures, and guidance for computing the Defense Logistics Agency's commercial activities inventory and that allows the installation commanders to prioritize the scheduling and studying of all functions in their commercial activities inventory.

DLA COMMENTS: Partially concur with the recommendation.

Concur that the Director, DLA, adhere to requirements of Executive Order 12615 and PL 100-0180, Section 1111 (Nichols Amendment). The Director, DLA, has complied with laws and regulations governing the CA program and will continue to obey the law. And, nothing in the audit report convincingly demonstrates that previous Directors have done otherwise.

Partially concur that, at a minimum, DLA issue a CA regulation that includes policies and guidance for computing the CA inventory and that allows installation Commanders to prioritize the scheduling and studying of all functions in their CA inventory. Additional CA guidance has been drafted as an addendum to DoDI 4100.33, Commercial Activities Program Procedures. This guidance has not been issued, pending implementation of a revised and reissued regulation. When guidance is revised to incorporate regulatory revisions, we will include guidance on the proper calculation of FTEs to ensure accuracy in the CA inventory.

However, guidance is not required to give Commanders authority to prioritize and schedule CA studies. Commanders currently have such authority under the Nichols Amendment.

DISPOSITION
( ) Action is considered complete.
(X) Action is ongoing; Final Estimated Completion Date: 31 October 1989
The action is ongoing to issue supplemental CA guidance, including a method for the accurate calculation of FTEs in the inventory. Final estimated completion date is dependent upon implementation of revised CA DoD Instruction. This should occur in October, 1989 and the supplemental guidance will be issued.

MONETARY BENEFITS: To be determined.
DLA COMMENTS:
ESTIMATED REALIZATION DATE:
AMOUNT REALIZED:
DATE REALIZED:

ACTION OFFICER: Charlie Frey, DLA-CBO

DLA APPROVAL: William J. Cassell

DEFENSE LOGISTICS AGENCY COMMENTS ON THE FINDING AND AUDIT RESPONSE

This appendix includes an extract of Defense Logistics Agency (DLA) comments on the finding as presented in a draft of this report. It also includes our response to management's comments. Management comments on the Recommendation and potential monetary benefits are addressed in Part II of this report. The complete management comments are included as Appendix C.

DLA Comment

Nonconcur with the statement that DLA has not made a concerted effort to perform studies. DLA has established a cooperative approach to studies; the installations perform the management studies and cost compilation, and Headquarters, DLA, assists in writing the Performance Work Statements (PWS's).

Audit Response

We do not consider the completion of 20 studies (22 percent of those announced) in 8 years to be a "concerted effort." We agree with DLA's cooperative approach to studies. However, we believe that the lack of timely studies has been caused, in part, by a lack of DLA Headquarters assistance. An effort should be made to provide timely support to the installation commanders.

DLA Comment

Nonconcur with the statement that the DLA decision to reclassify functions is contrary to the purpose of the Section 1111 of the National Defense Authorization Act for Fiscal Years 1988 and 1989, known as the Nichols Amendment. DLA has fully implemented both the Executive Order 12615 (the Executive Order) and the Nichols Amendment throughout the Agency. Regarding the reclassification, DLA made the following points.

a) The change in categorization resulted from a DoD request for an inventory report, which the Office of Management and Budget was going to use to project budget revisions in anticipation of savings expected from near-term studies.

b) The decision to defer functions was an operational matter within the authority of the Director, DLA, as Head of a DoD Component. DoD approval is required for exemptions, but not deferrals.

c) Deferrals were made in an effort to ensure effective studies, not to circumvent the law. Concerns arose because major systematic changes and operational upgrades are occurring in

mission areas. Moreover, these events are occurring incrementally and at different installations at different times. As a result, the development of precise PWS's and accurate cost compilations would be very difficult.

Audit Response

The purpose of the Executive Order and the Nichols Amendment is to expedite the review of commercial activities, not to delay the process (perhaps indefinitely) through reclassification of functions. The reclassification also prevented budget reductions.

We agree that the decision to defer functions is within the authority of the Director, DLA. However, when the effect of the deferral is noncompliance with the law, we believe OSD approval should have been requested by the Director, DLA, for the deferral.

Regarding the deferral of studies due to systematic changes and operational upgrades occurring incrementally, we do not consider this justification to be adequate. There will be planned or ongoing systematic changes and operational upgrades. Pending or ongoing change is not a valid reason for not taking action. The Executive Order astutely delegated to the installation commander the responsibility for performing the reviews and studies. Each commander will be aware of any near-term "incremental" changes at their installation and will adjust the reviews and studies to reflect the changes. In instances when the authority to study functions is withheld from the installations, a positive plan to complete these studies by DLA Headquarters should be in evidence.

We questioned the Military Departments on their automated data processing (ADP) systems and modernization plans for comparison with DLA. The Army has an ADP modernization effort in effect; however, it is studying ADP functions. The Navy has an ADP modernization effort in effect; however, it is performing cost comparisons on computer operations. In summary, Program reviews and studies can be performed during modernization efforts by DLA.

DLA Comment

Concur with the statement that DLA will not meet the 3-percent study goal set forth in the Executive order.

Audit Response

We agree with DLA's concurrence.

DLA Comment

Nonconcur that the length of time required to perform PWS's increased because generic PWS's prepared by Headquarters, DLA, were used. Delays are primarily the result of long reviews and

re-drafting cycles. Contributing factors are changes in assigned personnel and resolution of PWS comments by correspondence.

Audit Response

The report has been modified to indicate that generic PWS's were partly the cause for lengthy studies. If DLA management were committed to the performance of the commercial activity studies, there would be fewer delays caused by reviews and re-drafting cycles on the PWS's.

DLA Comment

Nonconcur with the statement that DLA continues to have a high level staff of 12 employees dedicated to the future possibility of performing commercial activity studies. This staff of 12 was reallocated in late 1988 and the commercial activities staff now consists of 2 full-time analysts and 1 Secretary/Administrative Assistant on a part-time basis.

Audit Response

The report has been modified to indicate the change in the quantity of staff. Such a reduction in dedicated Headquarters staffing raises doubt about DLA's commitment to the program.

POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefits	Amount and/or Type of Benefit
Recommendation A.	Economy and Efficiency	Cost Avoidance
	Performing commercial activity studies results in a competition between the Government in-house most efficient organization (MEO) and commercial contractors. The Government must show that it can perform the service at the least cost based on the MEO or award a contract for the service to the private sector.	An estimated $61.5 million could be saved, during a 5-year period, if 3 percent of DLA's commercial activity inventory were studied in accordance with the Executive Order. (Appropriation 97 0100 Operation and Maintenance, Defense Agencies.)

Note: In this audit report we stated that up to $61.5 million in reportable cost avoidances, during a 5-year period, could be achieved. We are recognizing that as more and more functions are studied, you will reach a point of diminishing returns. We use the word "reportable" because of Defense Manpower Data Center's (DMDC) reporting procedures. Instead of reporting total cost avoidances over the length of the cost comparison period, the DMDC procedures annualize the contract or in-house costs and report only the cost avoidances achieved in the first year of operation. Accordingly, the amount of the annual potential monetary benefits is $12.3 million with claimed cost avoidances of up to $61.5 million during a 5-year period. Our estimate, therefore, is very conservative since the reductions in manpower produce cost avoidances not only for the first year, but also produce cost avoidances for the subsequent years.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Assistant Secretary of Defense (Production and Logistics), Washington, DC

Department of the Army

Headquarters, Department of the Army, Washington, DC
Army Materiel Command, Alexandria, VA

Department of the Navy

Headquarters, Department of the Navy, Washington, DC

Department of the Air Force

Headquarters, Department of the Air Force, Washington, DC

Marine Corps

Headquarters, Marine Corps, Arlington, VA

Defense Logistics Agency

Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Contract Administration Services Region, Chicago, IL
Defense Contract Administration Services Region, Los Angeles, CA
Defense Depot, Mechanicsburg, PA
Defense Depot, Tracy, CA
Defense Industrial Supply Center, Philadelphia, PA
Defense Electronics Supply Center, Dayton, OH
Defense Administrative Support Center, Alexandria, VA
Defense Logistics Services Center, Battle Creek, MI
Defense Reutilization and Marketing Service, Battle Creek, MI

Other Defense Activities

Defense Manpower Data Center, Arlington, VA

Non-DoD Activities

Congressman William Nichols' Office, Washington, DC
Office of Management and Budget, Washington, DC

AUDIT TEAM MEMBERS

Donald Reed, Director, Logistics Support Directorate
Shelton Young, Deputy Director, Logistics Support Directorate
Allen Wyllie, Program Director
Dorothy Roberts, Acting Project Manager
Carolyn Milbourne, Team Leader
Sandford Stone, Team Leader
Suzanne Hutcherson, Auditor
Beth Kilborn, Auditor

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Air Force Audit Agency

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