DEFENSE-WIDE WORKING CAPITAL FUND
Fiscal Year (FY) 2004/FY 2005 BIENNIAL BUDGET ESTIMATE
OVERVIEW

DEFENSE LOGISTICS AGENCY

The Defense Logistics Agency (DLA) is a Combat Support Agency responsible for providing the Military Services with a broad range of logistics support. Responsibilities include the acquisition, storage, and distribution of most of the Department of Defense's (DoD) spare parts and other consumable items, reutilization and marketing of excess military property, document automation services, and operation of the Defense National Stockpile. DLA directly contributes to the warfighting readiness and sustainability of U.S. forces, literally "around the clock - around the world".

Most of these responsibilities are carried out by activity groups operating within the Defense-Wide Working Capital Fund. The DLA portion of the Fund consists of the following four activity groups:

- Supply Management
- Distribution Depots
- Reutilization and Marketing
- Document Automation and Production Service

This submission reflects DLA's continued commitment to execute our DLA 21 goals and implementation of the DLA Strategic Plan through aggressive use of business process reengineering, competitive and strategic sourcing, acquisition reform, and use of emerging technology to reduce infrastructure costs while sustaining readiness support to the warfighter. Specifically, this submission includes:

♦ DLA Performance Contract goals and metrics for all major DLA Activity Groups.

♦ Supply Customer Price Change (CPC) of -2.9% in FY 2004.

♦ The DLA Distribution Depots will assume responsibility for first destination transportation costs from the Inventory Control Points beginning in FY 2004.

♦ A new pricing structure, Transaction Activity Billings (TAB)for the Defense Reutilization and Marketing Service is used for Service Level Billing (SLB).

♦ $145.9 million in our budget to fund the FY 2004 milestones of the Business Systems Modernization (BSM) initiative.

- Full-time equivalent reductions of 13% since the beginning of FY 2000 through FY 2004.

Detailed highlights by activity group follow:

Supply Management Activity Group

The DLA Supply Management Activity Group incorporates those activities, programs and costs related to material management. Costs include operations (salaries and expenses), material (items sold to the military services) and capital investments (purchase of equipment, software development and minor construction). Approximately twenty-four million requisitions are received annually from the military services and other federal agencies for the four million six hundred thousand consumable items managed by DLA.

The DLA Supply Management Activity Group is broken into wholesale and retail level inventories. Wholesale inventories are inventories the manager has asset knowledge and control over, regardless of funding sources. Retail inventory (or base supply) provides equipment, materials, supplies and services to local DLA activities and authorized tenants. Four Inventory Control Points (ICPs) manage DLA's wholesale inventories. These ICPs provide the warfighter with Fuel, Troop Support (uniforms, food and medical), General Support (hardware type items), and Weapons Systems Support. DLA's retail management consists of Base Operating Support (BOS) and the National Security Agency (NSA). In addition, DLA's Supply management includes a small number of supporting activities, such as the Defense Logistics Information Service (DLIS) and the Defense Automated Addressing Systems Center (DAASC).

In FY 2002, the Defense Energy Support Center capitalized Aerospace Missile Fuels from the Air Force valued at $77.4 million. DLA is reflecting capitalization of this inventory on inventory exhibits separately from petroleum.

To improve the accounting for and make the cost of government programs more visible to the American people, the Administration is proposing to align the full annual budgetary costs of resources used by programs with the budget accounts that fund the programs. To that end, the budget includes a request for a direct appropriation of $242.4 million for the Working Capital Fund Supply Management Activity Group to fund the Aviation Investment Strategy, DFAS systems costs, funding to conduct a comprehensive survey of fuel facilities to evaluate sustainment and restoration requirements, and unused distribution warehouse space. This proposal does not increase the total costs to the Federal government, since these costs were previously funded from a central account.

Based upon the DLA's FY 2000 Performance Contract commitments, DLA was tasked to determine how to achieve a weapon system supply availability goal of 85 percent for each of the Military Services. Although DLA is already achieving an aggregate weapon system supply availability of 85 percent, Air Force and Navy support is below that level. Analysis has indicated that overall supply availability is being negatively impacted by items related to aviation support. To improve the availability of aviation spare parts, $500 million in appropriated funding is included in the Air Force and Navy Operations and Maintenance accounts for additional support beginning in FY 2001 through FY 2004. The *appropriated* amounts included are $100 million, $147.9 million, $133.1 million and $119 million, respectively, per fiscal year. DLA will procure $334 million in aviation spare parts, $120 million in aviation engine spares and $46 million to support aviation non-demand items. Procurement actions began in FY 2000.

Defense Logistics Information Service is resourced through a Service Level Billing (SLB) to each DoD Supply Management Activity Group (Army, Navy, Air Force and DLA). The services provided by DLIS are Information Management (IM), Information Dissemination (ID) and Cataloging. In FY 2003, the method for allocating the SLB is an equal allocation for IM; customer usage for ID; and the number of national stock numbers managed for Cataloging. This method is commonly referred to as the Primary Inventory Control Activity (PICA). Costs are increased across budget years to reflect increased Defense Information Systems Agency costs and a conversion effort for Catalog Reengineering and Customer Relations Management.

The Defense Automated Addressing Systems Center is also financed via a service level billing, with each Supply Management Activity financing an equal portion of DAASC's costs. DAASC cost increases are attributable to software maintenance increases, Information Assurance, Core Mapping Sustainment, and Logistics Data Gateway.

The DLA Supply Management Budget includes Commitment Authority which is the administrative reservation of funds for future obligations. It allows additional obligations on a dollar-for-dollar basis when customer orders (demands) increase, or when prices, such as fuel prices, rise during the fiscal year. The estimates for non-energy for FY 2003–FY 2005 reflect three months of commitments for each fiscal year, in anticipation of additional sales to support OEF and to address uncertainty in continued world events. The FY 2004 commitment authority for Non-Energy is $3.4 billion and for Energy is $107.6 million.

The Customer Price Change (CPC) is the average change in price from one year to the next that the customer will encounter for the average non-energy item. DLA's goal is to have a CPC of no greater than the DoD composite inflation factor. Changes in customer price are driven by factors such as: inflation, basic costs incurred to procure, store, and ship to the customer; and possibly other DoD decisions. The FY 2003 CPC is 3.5 percent and the FY 2004 CPC is -2.9 percent. The FY 2003 increase is primarily due to a capital surcharge to ensure sufficient cash levels for capital investments disbursements as they occur. The FY 2004 decrease is primarily due to the realignment of unique military readiness costs such as reutilization costs and excess distribution warehouse costs that will be financed through direct appropriations, and over-ocean transportation costs that will be paid directly by the consuming Service.

The DLA has received claims totaling nearly $2.7 billion from thirty fuel supply contractors. The claims allege that DESC has used an unauthorized price adjustment clause since the early 1980s. The contracting officer has denied all of the claims (three are pending), and 16 denials involving $2 billion have been appealed to the United States Court of Federal Claims. None of the potential claims has advanced to the point to include in this budget submission. DLA does not agree that the price adjustment clause was unauthorized and intends to contest the claims. We further believe, in any event, that the claims are vastly overstated. However, on May 10, 2000, the United States Court of Federal Claims awarded Pride Companies, L.P. $45.7 million because of an unauthorized price adjustment clause in Pride's contracts providing refined fuel products from 1987 – 1992. With interest, the total payment was $61.5 million. Pride was paid in FY 2000. More recently, in October 2002, in the Gold Line case, the Court again determined the clause to be unauthorized. Neither the Pride nor the Gold Line case is expected to be a precedent for future cases.

The Office of Management and Budget establishes fuel rates with input from the Departments of Defense, Energy, Treasury, and Commerce. The single most important cost factor is the world petroleum market price/product cost. While this product cost is outside DLA's direct control, several acquisition and materiel management techniques are used to mitigate rising costs. Acquisition techniques include flexible (seasonal or spot) buying, dollar cost averaging, market sensitive ordering, commercial buying of bunker fuels, minimal small and disadvantaged business premium payments, and the increased use of commercial specifications. Materiel management techniques include improved requirements forecasting and using refinery production capacity in place of product to support the Military Services War Reserve requirement. Additionally, DLA is continually changing its storage and transportation methods in search of efficiencies without impeding petroleum support effectiveness. In FY 2004, the standard price for petroleum is $38.22 per barrel and the standard price for missile fuels is $8.45 (composite).

Activity Group Profile

	FY 2002	FY 2003	FY 2004	FY 2005
($ in Millions)				
Cost of Goods Sold	$14,459.3	$14,762.9	$13,768.9	$14,130.7
Net Operating Results	$1,279.2	$70.8	($676.3)	$65.9
Accumulated Operating Results	$301.0	$371.8	($304.5)	($238.6)
Civilian Full-Time Equivalents	11,404	11,599	11,252	11,034
Military Workyears	371	371	371	371
Capital Budget Program Authority	$160.8	$279.8	$213.3	$112.5

Distribution Depots Activity Group

The Defense Logistics Agency (DLA) Distribution Depot Activity Group is responsible for the global distribution and warehousing of Military Service and DLA line items. These items consist of wholesale DoD weapon systems parts and other defense related consumable items to include medical, clothing, subsistence, electrical, industrial and general supplies. In FY 2002, the distribution depots, by location and component are:

DLA
Columbus, OH
San Joaquin, CA
Richmond, VA
Susquehanna, PA
Germersheim, Germany
Map Support, Richmond, VA

Navy
Cherry Point, NC
San Diego, CA
Jacksonville, FL
Norfolk, VA
Puget Sound, WA
Pearl Harbor, HI
Yokosuka, Japan

Marines
Albany, GA
Barstow, CA

Army
Anniston, AL
Corpus Christi, TX
Red River, TX
Tobyhanna, PA

Air Force
Hill, UT
McClellan, CA
Oklahoma City, OK
Warner Robins, GA

These depots, strategically located throughout the world, received and issued almost 23 million secondary lines and warehoused and maintained over 225 million cubic feet of material. The Defense Distribution Depot network insures that America’s war fighters receive the best value in distribution services. All items are typically prepared and shipped within one day of receiving the shipping order.

Since “9/11”, the Distribution Depot Activity Group has seen unprogrammed increases in workload and transportation costs. Other challenges facing this business area include downsizing, an aging workforce, and A-76 competition and resulting transitions. The continuing challenge is to identify the most cost-effective way of getting the right product to the right place at the right time. The war fighters are requiring DLA to change business practices to reduce customer wait time, meet time definite delivery standards, and reduce costs. Understanding both tactical and strategic supply chain management and DLA's role in creating the DoD distribution system for the 21st century is critical. Some of the cost increases DLA has experienced over the budget period include:

- Transportation – The FY 2004 estimate of $630.8 million is for the continued support of Operation Enduring Freedom theater of operations ($112 million), increased air shipments, increased shipment weights, increased freight surcharges, and transporting less than truck load shipments.

- Combating Terrorism– Increases over the budget period are the result of Antiterrorism Vulnerability Assessments, Security Assistance Visits and Depot Commander's security requests as a result of September 11, 2001. The DDC is also upgrading or implementing Common Access Card systems at all DDC activities to better serve physical access to buildings and controlled areas.

- Regulating Wood Packaging Materiel in International Trade – The approval of an international packaging standard required all raw wood packaging to be treated to reduce the introduction/spread of pests associated with wood packaging. The increased packaging supply costs are for treating lumber and certifying that all export shipments with wood packaging are pest free.

- First Destination Transportation (Lead Center for Distribution) - Beginning in FY 2004, the DDC will assume responsibility for first destination costs from the Inventory Control Points. This initiative will provide intransit visibility for freight on board origin direct vendor deliveries. Estimated reimbursable costs for FY 2004 are $41.3 million.

Initiatives for savings included in this submission aim at reducing infrastructure, eliminating duplicate functions, and streamlining business processes. Some initiatives include:

- Providing Strategic Distribution Enhancements –
    - Increase in dedicated truck routes allows for shipments to be consolidated and directed from premium /unscheduled modes of transportation to existing scheduled/dedicated truck routes at a significant cost reduction.
    - Divert shipments to new scheduled service. Shipping to customers via scheduled/dedicated truck provides time definite delivery at the lowest cost. Adding additional stop-offs to existing routes allows small customers to receive scheduled/dedicated truck support at a marginal additional cost.

- Forward stock positioning. In an effort to meet U.S. Forces demand in the European theater and to reduce the transportation costs of airlifting material stored in CONUS, DLA has forward positioned some 26,000 National Stock Numbers (NSN) at Distribution Depot Germersheim, Germany. As part of this effort DLA will ship supplies to Europe by more economical surface ship transportation. Orders will then be processed and shipped by surface for European customer's directly out of Germersheim. Using surface transportation to ship supplies will significantly reduce Customer Wait Time, processing costs and storage costs.

- Installing the Distribution Planning and Management System (DPMS) - DPMS will allow the DDC to evaluate and optimize transportation operations to better manage material flow from vendors and distribution centers to the customer. The use of DPMS will allow the DDC to lower transportation and inventory holding costs. DPMS has a slight investment cost for FY 2004 with savings projected for FYs 2005-2009.

DLA has been able to make great strides in reducing the number of depots through mergers and Base Realignment and Closure (BRAC) decisions in 1993 and 1995, going from 30 CONUS depots in 1992 to 18 CONUS depots by the end of 2001. Since depot consolidation, three depots have been established in the European and Pacific theatres (Pearl Harbor, Hawaii; Yokosuka, Japan; and Germersheim, Germany) and one specialized distribution depot for handling maps has been added.

Activity Group Profile

	($ in Millions)			
	FY 2002	FY 2003	FY 2004	FY 2005
Net Operating Results	($3.8)	($46.4)	($23.1)	($0.0)
Accumulated Operating Results	$0.0	$0.0	$0.0	$0.0
Civilian Full-Time Equivalents	8,526	8,178	8,016	7,381
Military Workyears	178	178	178	178
Capital Budget Program Authority	$33.7	$51.2	$58.3	$39.7

Reutilization and Marketing Activity Group

The Defense Logistics Agency (DLA) Defense Reutilization and Marketing Service (DRMS) Activity Group is responsible for the reuse, or reutilization, of excess and surplus personal property within the Department of Defense (DoD). Items received by the DLA Defense

Reutilization and Marketing Offices (DRMOs) meeting Military Services item manager criteria are automatically referred through front-end screening notices. The Military Services reutilized approximately $1.23 billion worth of personal property in FY 2002, resulting in savings to the DoD and the Government. If property is not reutilized, it can be transferred to other Federal agencies. Remaining property becomes surplus and is made available for donation to authorized state agencies and charitable organizations. The balance of property is offered for competitive sale to the public.

The DLA disposal mission includes hazardous property disposition. In this capacity, DLA handles the vast majority of DoD property governed by the Resource Conservation Recovery Act (RCRA) of 1976, as amended. Some hazardous material has reutilization and/or sales value and goes through the same process as all other DoD property. However, once it has been screened for potential reutilization or sales value, all hazardous waste is directly disposed of through contracts managed by DLA and funded by the Military Services.

DRMS headquarters, responsible for operational control, is located in Battle Creek, Michigan. The operational core of this organization lies with individual DRMOs located on military installations throughout the world. DRMOs receive, classify, segregate, demilitarize, account for and report excess material for screening, lotting, merchandising, and sales.

DRMS has adopted a corporate strategy of focusing, managing, and measuring logistics support based on customer needs; consistently providing responsive, best value supplies and services to their customers. DRMS is transitioning from being geography based to customer needs based.

Workload projections were reviewed and revised based on input from DRMS generators as well as from the DRMS National and International Commands. The Services are doing a better job of managing their inventories and thus generating less excess property; therefore, a decline of workload is reflected, 5 percent decrease from FY 2002 through 2004 in acquisition value and a 7 percent decrease in line items. We anticipate workload continuing to decline through FY 2004 and leveling off in the outyears. However, these workload projections could be impacted by returns from Operation Enduring Freedom and any new rounds of BRAC closures.

In addition to the decline in the volume of workload, the quality of property received has also fallen. This drop in quality as well as changes to the computer hard drive policy have lead to more property being downgraded to scrap upon receipt. While these factors negatively impact the percent of property reutilized, transferred, and donated, they have a bigger impact on the amount of usable property available for sale. Therefore, there have been some adjustments within all the Business Units workload projections. Revenue projections have been adjusted to reflect the higher downgrade to scrap rate and a downturn in the scrap market.

Activity Group Profile

	($ in Millions)			
	FY 2002	FY 2003	FY 2004	FY 2005
Sales	$356.2	$333.5	$307.6	$279.9
Net Operating Results	$56.9	$41.4	$11.4	$0.0
Accumulated Operating Results	($52.8)	($11.4)	$0.0	$0.0
Civilian Full-Time Equivalents	1,984	1,749	1,641	1,541
Military Workyears	9	9	9	9
Capital Budget Program Authority	$8.2	$8.1	$7.7	$4.7

Document Automation and Production Service Activity Group

The Document Automation and Production Service (DAPS) is responsible for the DoD printing, duplicating, and document automation programs. This responsibility encompasses the full range of automated printing services to include: conversion, electronic storage and output, and the distribution of hard copy and digital information. DAPS provides time sensitive, competitively priced, high quality products and services that are produced either in-house or procured through the Government Printing Office (GPO).

DAPS manages this worldwide mission through a customer service network comprised of a Headquarters located at Mechanicsburg, Pennsylvania and 185 smaller document automation facilities.

In FY 2002, DAPS implemented a Most Efficient Organization (MEO) resulting from an A-76 study decision. DoD investment in the MEO during FY 2002 was approximately $27 million. Implementation of the MEO resulted in consolidation of 93 of the DAPS locations (36%) as well as, the upgrade, replacement and/or disposal of over 300 equipment items. In addition, 255 (19%) of the total DAPS personnel were downsized.

The Department is reviewing alternatives to the current operation and structure of DAPS, based on the premise that the DAPS functions may not be inherently governmental and other sources may exist for these services. The review will address mission transfer and alternative sourcing in the public or private sectors and will be completed by July 2003. Pending any adjustments that may be appropriate as a result of this review, the budget reflects the discontinuation of DAPS as currently structured (less inclusion of related financial results in the DWWCF) beginning in FY 2004 with a completion date in FY 2005.

To minimize the potential impact on personnel, this budget funds $+13.4 million in both FY 2004 and FY 2005 for voluntary separation incentive pay (VSIP) and voluntary early retirement authority (VERA).

Activity Group Profile

	($ in Millions)			
	FY 2001	FY 2002	FY 2003	FY 2005
Cost of Goods Sold	$422.7	$381.0	$387.1	$371.9
Net Operating Results	($34.3)	$45.8	$5.1	$18.8
Accumulated Operating Results	($52.8)	($7.0)	($1.9)	$16.9
Civilian Full-Time Equivalents	1,299	1,126	723	180
Military Workyears	0	0	0	0
Capital Budget Program Authority	$7.5	$5.9	$0.0	$0.0