DEFENSE LOGISTICS AGENCY
Defense-Wide working Capital Fund
Distribution Depots
Fiscal Year (FY) 2003 Budget Estimates
February 2002

FUNCTIONAL DESCRIPTION

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 2001, the distribution depots, by location and component are:

DLA	**Navy**	**Army**	**Air Force**
Columbus, OH	Cherry Point, NC	Anniston, AL	Hill, UT
San Joaquin, CA	San Diego, CA	Corpus Christi, TX	McClellan, CA
Richmond, VA	Jacksonville, FL	Red River, TX	Oklahoma City, OK
Susquehanna, PA	Norfolk, VA	Tobyhanna, PA	Warner Robins, GA
Germersheim, Germany	Puget Sound, WA		San Antonio, TX
Map Support, Richmond, VA	Pearl Harbor, HI		
	Yokosuka, Japan		
	Marines		
	Albany, GA		
	Barstow, CA		

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 by providing “around the clock - around the world” world-class service for the least cost to the taxpayers. All items are typically prepared and shipped within one day of receiving the shipping order.

CHANGES IN OPERATIONS

Since FY 1998, the Distribution Depot Activity Group has made great strides in reducing infrastructure, eliminating duplicate functions, and streamlining the way we do business. Examples of these efforts include:

- Reengineering DLA’s Strategic Distribution Platforms (SDPs) located at the Defense Distribution Depot San Joaquin California, and at the Defense Distribution Depot Susquehanna Pennsylvania. At both SDPs, the reengineering efforts involved rewarehousing material from nearby facilities and eliminating duplicate functions. These actions resulted in the reduction of more than 700 employees and a substantial increase in productivity at the two sites.

- Closing the two remaining Base Realignment and Closure (BRAC) depots, Distribution Depot San Antonio, TX, and Distribution Depot McClellan, CA in July 2001. The closure of these last two facilities completed facility reductions to the Distribution Activity Group under existing BRAC legislation.

- Completing the A-76 competition of the first five of sixteen depots with private industry.

    - The first competition award announced in November 1999, resulted in the Defense Distribution Depot Columbus, OH retaining depot operations and management in house.
    - The next two competition awards announced January 2000 for the Defense Distribution Depot Barstow, CA (DDBC) and February 2000 for the Defense Distribution Depot Warner Robins GA, resulted in contracting out the operations and management functions for both depots to EG&G Logistics, Inc.
    - The last two competition awards announced to date were for the Defense Distribution Depot Jacksonville, FL during March 2001, and the Defense Distribution Depot Cherry Point, NC during May 2001. These depots were contracted out to MANCON of Virginia Beach, VA and LABAT-Anderson of McLean, VA, respectively.

    On January 11, 2002 the Defense Distribution Depot Richmond, VA competition resulted in a tentative decision to retain depot operations and management in house.

Three additional competitions are pending tentative decisions in FY 2002: Defense Distribution Depot San Diego, CA; Defense Distribution Depot Hill, UT; and Defense Distribution Depot Albany, GA. The process follows federal policy for deciding whether to retain recurring, commercial-like activities within the government or contract them out to a private sector source. The goal of the program is to reduce costs through the competitive process and through process reengineering. These competitions will provide quality support and significant cost savings to the war fighters in the years to come.

DLA announced competition of the seven remaining Continental United States depots during October 2001. We expect decisions on four of the depots in FY 2003 and decisions on the remaining three depots in FY 2004. We will announce the two final studies of the support functions at the SDPs at the end of FY 2002.

Estimated cost assumptions/savings for the competitions are as follows:

- Study costs estimated at $4,000 per full-time equivalent (FTE);
- Severance costs for personnel reductions and contract conversions for half of the depots being studied estimated at $28,000 per FTE.
- Savings reflect an increase to a net 25%.

FTE and labor savings budgeted include only most efficient organization (MEO) savings. Costs and savings are prorated to the fiscal year in which they are expected to occur. The entire A-76 process should be completed by the end of FY 2005.

The metrics for this activity group are outlined in the Performance Contract. These metrics include: (1) operating results; (2) competitions for depots; (3) unit costs for distribution services, (4) total cost for distribution services; (5) inventory accuracy for products, (6) location accuracy for products; and (7) customer satisfaction index. These metrics establish minimum performance targets for this Activity group in order to achieve or exceed established targets.

Consistent with activity based costing techniques, in FY 2002, DLA implemented the Net Landed Cost pricing mechanism at the Distribution Depots. Net Landed Cost provides our customers with visibility of their distribution costs by commodity, customer, and transactions so that they may make more informed supply decisions as well as develop more accurate surcharges.

The previous pricing methodology did not reflect the varying levels of distribution services rendered. Customers were not aware of the cost implications of specifying either routine; priority; special levels/value of added services; or cost drivers of the varying materiel DLA handles. The use of average line item costs did not reflect the actual level of effort expended with respect to individual items processed. Without this level of detail, precise costs cannot be determined and subsequently used as a mechanism for developing competitive prices.

As the next step in the process of aligning costs more accurately, we have applied our ABC techniques to the cost drivers for the storage mission and have realigned our costs to apply Net Landed Cost to the Storage mission. During FY 2001, we executed an intense program to correct storage data, specifically item weight and cube. This initiative measures the actual size of an item rather than the space it occupies in the depot. In doing so, there have been some shifts in costs between customers. These shifts are a more accurate reflection of the true costs of our business processes by appropriate customer.

To date, overall performance has improved while costs continue to decrease. Continuing process efficiencies, steady drops in mission workload and contracting out depot workload have led to significant reductions to the distribution workforce. Endstrength dropped from 25,372 in FY 1992 to a projected 8,357 in FY 2003, a reduction of 17,015 personnel, or a 67 percent decrease. Reductions to date have been accomplished mainly through the use of Voluntary Separation Incentive Pay (VSIP) and Voluntary Early Retirement Authority (VERA). Various Reductions-in-Force (RIFs) conducted during FY 2001 resulted in 79 separations. To maintain the appropriate balance of workforce to workload, additional RIFs will be conducted, as necessary, during FYs 2002/2003.

BUDGETING AND MANAGING FOR RESULTS

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 $36.9 million for Distribution to fund the full accruing cost of the Civil Service Retirement System and retiree health benefits for civilian employees in the Federal Employee Health Benefit Program. Beginning with the FY 2004 Budget, these costs will be built into the rates charged to Working Capital Fund customers. This proposal does not increase the total costs to the Federal government, since these costs were previously funded from a central account.

PERSONNEL PROFILE:

	FY 2001	FY 2002	FY 2003
Civilian End Strength	8,989	8,906	8,357
Civilian Full Time Equivalents (FTEs)	9,052	8,929	8,430
Military End Strength	177	178	178

BUDGET HIGHLIGHTS:

WORKLOAD:

Lines Received and Shipped:

Lines processed (either received or shipped) are the basic work count. Workload is budgeted to decline 6.2 percent over the budget period. Although this continues a long trend, as changes in logistics methods reduce distribution depot workload, this decrease in workload has slowed over the past several years. Reengineering initiatives such as Premium Service and Virtual Prime Vendor, and a general decline in customer demands, will continue this trend at a reduced rate for the foreseeable future. These estimates reflect the budgeted forecasts.

Lines Received and Shipped (Millions)

FY 2001	FY 2002	FY 2003
22.7	22.2	21.3

Storage:

Since inventory managers began paying for storage in FY 1996, storage volume at the depots has decreased. The FY 2003 estimate reflects Net Landed Cost (NLC) for storage based on item cubic feet. The correction of storage data through a joint Service effort resulted in more accurate item cube data. Using NLC, DLA will bill the customer for material (based upon total item cube) stored in our warehouses. In so doing, we will fully automate a previously manual process and will bring storage billing into real-time billing vice billing based on prior period workload. This visibility allows our customers, to determine the level of inventory they want to maintain in DLA storage. We expect a continued decrease in workload in this business area as a result of continued scrutiny of storage data reports and initiatives to maximize use of commercial vendor stocks.

	Average Cubic Feet Occupied (Millions)		Item Cube (Millions)
	FY 2001 1/	FY 2002 1/	FY 2003 2/
Covered Storage Space	233.0	224.2	55.6
Specialized Storage			8.3
Open Storage Space	61.6	46.3	28.7

1/ Based on occupied cubic feet (the entire area used to store material in racks, bins and bulk storage space)
2/ Based on item cubic feet (the actual packaged material cube)

REVENUE:

Revenue for the Distribution Depots Activity Group consists of payments from the Supply Management Activity Groups of DLA and the Military Services for lines received and shipped, for item storage, and reimbursable funding provided by inventory managers or local activities to depots for special project work. Inventory

Control Points in supply management include their distribution depot costs in the surcharges applied to sales of materiel that they manage.

Lines Received and Shipped:

The current rate structure includes Net Landed Cost (a matrix of prices for lines received and shipped to reflect the varying levels of distribution services rendered), a separate pricing structure for storage services and an hourly reimbursable rate.

The Net Landed Cost pricing structure provides our customers with greater visibility of their distribution costs by commodity, customer, and transactions in order for them to make more informed supply decisions. Cost visibility is enhanced due to the following elements of our new rate structure:

(1) Transportation costs are excluded from NLC rates. The ICPs will be billed actual transportation costs for each transaction. Linking actual transportation with the customer's bill involves them in the decision process and is a key element in driving distribution costs to the proper levels. This is a significant change from the previous process in which requisitioning customers were able to make decisions that required premium transportation without any direct financial impact on their costs.

(2) Receipts, Issues, Issues from Receiving, and Off-base Transshipments include a basic charge and additional charges for extended weight of the line.

(3) Value Added Services – Returns, Hard to Handle, Hazardous, Controlled Items, Foreign Military Sales, Out-of-Cycle, and Local Delivery items also incur additional charges. These are services that are beyond the basic services, thus requiring additional processing.

The following table outlines our rate schedule under Net Landed Cost:

Net Landed Cost Billing Rates

	FY02	FY03	
Receipt			
Base	$21.88	$26.94	
Plus			
1-40 lbs.	$1.37	$1.40	
40-150 lbs.	$8.41	$9.31	
150-2000 lbs.	$21.95	$23.16	
2000+ lbs.	$0.0080	$0.0098	per lb.+ 150-2000 rate
Return	$3.87	$3.90	per line additional
Hazardous	$13.11	$13.15	per line additional
Hard-to-Handle	$13.11	$13.15	per line additional
Issue			
Onbase	$8.92	$11.00	per line
Plus			
1-40 lbs.	$1.37	$1.40	per line
40-150 lbs.	$8.41	$9.31	per line
150-2000 lbs.	$21.95	$23.16	per line
2000+ lbs.	$0.0080	$0.0098	per lb.+ 150-2000 rate
Offbase Base	$13.00	$15.21	per line
1-40 lbs.	$2.34	$2.50	per line
40-150 lbs.	$18.69	$21.07	per line
150-2000 lbs.	$37.51	$41.07	per line
2000+ lbs.	$0.0105	$0.0129	per lb.+ 150-2000 rate
Hazardous	$13.11	$13.15	per line additional
Controlled Item	$6.47	$6.63	per line additional
Hard-to-Handle	$13.11	$13.15	per line additional
FMS	$6.43	$6.49	per line additional
Out-of Cycle	$17.60	$17.35	per line additional
Local Delivery	$1.25	$1.24	per line additional
Issue from Receiving			
Base	$1.17	$1.19	per line
Plus			
1-40 lbs.	$1.37	$1.40	per line
40-150 lbs.	$8.41	$9.31	per line
150-2000 lbs.	$21.95	$23.16	per line
2000+ lbs.	$0.0080	$0.0098	per lb. + 150-2000 rate
Transshipments			
MarkFor	$4.72	$5.56	per line
Onbase	$8.61	$10.57	per line
Offbase	$17.99	$21.09	per line
1-40 lbs.	$2.34	$2.50	per line
40-150 lbs.	$18.69	$21.07	per line
150-2000 lbs.	$37.51	$41.07	per line
2000+ lbs.	$0.0105	$0.0129	per lb. + 150-2000 rate
Estimated Transportation	$145,100,000	$139,200,000	

Composite Rate with Transportation	$26.12	$28.64
Composite Rate w/o Transportation	$19.18	$21.81

Storage Rates. As stated previously, we have applied our ABC techniques by looking at the cost drivers for storage and have realigned our costs accordingly. Because the workload is decreasing faster than costs, and because storage charges are built on prior-year workload averaging, we have incorporated Net Landed Cost (cost per item cube) in FY 2003. While the FY 2003 storage rate to customers is over two-thirds higher, conversely the workload is almost two-thirds lower. Total costs remain the same. In addition, we have added an additional rate, Specialized Storage, for those items in controlled facilities, such as hazardous, controlled humidity, chill vault, freeze and flammable warehouse facilities.

The last two depots closed under BRAC in FY 2001, left an infrastructure still in excess of distribution depot requirements. To the extent possible, we are continuing to vacate warehouses and return them to hosts/owners. Only through reduced inventory can we reduce our fixed costs – infrastructure – and pass these savings to our customers. With Net Landed Cost for storage, our customers will be provided item cube data at the national stock number level by distribution center, which will help the customer make better sourcing decisions.

Average Cost Per Cubic Foot

	FY 2001 1/	FY 2002 1/	FY 2003 2/
Covered Storage	$0.83	$0.99	$3.368
Specialized			$4.765
Open Storage	$0.17	$0.20	$0.696

1/ Based on occupied cubic feet
2/ Based on item cubic feet

Reimbursables. A nationwide reimbursable rate of $66.89 per direct labor hour was established in FY 1998 for labor performed for and paid by other activities. Beginning in FY 2001 we established two rates to capture workload performed: 1) at DLA facilities, and 2) at customer facilities. In FY 2002 we realigned overhead costs in keeping with aligning costs where costs belong. For FY 2003 our hourly rates reflect our costs for a workload estimate of 1.2 million hours, which is a 20 percent decrease over the budget period. We will continue to pursue a NLC pricing structure for reengineering reimbursable rates to provide more visibility and cost control to our customers.

	FY 2001	FY 2002	FY 2003
DLA Facilities	$68.36	$63.12	$64.14
Non-DLA Facilities	$52.55	$52.55	$53.23

Note: Non-DLA facilities rate excludes costs for utilities, maintenance, and corporate overhead

Over-Ocean Transportation/Container Consolidation Point (OOT/CCP). We budgeted for full recovery of Over-Ocean Transportation (OOT) and Container Consolidation Point (CCP) costs. Bosnia costs remain constant at $15M through FY 2003. In consonant with current transportation costs experienced during FY 2001, anticipation of lower transportation costs due to reduced workload, and a more accurate realignment of overhead costs, we have reduced FY 2003 OOT/CCP workload (excluding Bosnia) by $32 million lower than the level reflected in President's Budget 2002.

We remain convinced that the current policy needs to link these costs to the customers who incur them (i.e., since the costs are included in Supply rates, they are not discretely visible or chargeable to individual customers). Simply stated, the costs should be aligned with the component driving the costs. We continue to pursue other avenues of recouping these costs to enhance customer visibility and to impact customer behavior in order to drive these costs down.

Capital Investments:

The Capital Investment Program for distribution finances the reinvestment of the infrastructure for this activity group. The Distribution Depot Activity Group submits the following requirements:

	(Dollars in Millions)		
	FY 2001	FY 2002	FY 2003
Equipment (non-ADP)	$15.9	$16.3	$14.5
Equipment (ADP/T)	11.3	6.8	17.8
Software Development	3.5	1.7	11.5
Minor Construction	10.0	7.3	7.5
TOTAL	$40.7	$32.1	$51.3

For non-ADP equipment there is a small reduction in replacement equipment and requirements for productivity equipment enhancements in New Cumberland, PA; Yokosuka, Japan; and Germersheim, Germany. For ADP/T equipment in FY 2003, we will upgrade LAN telecommunications infrastructures at seven depots to improve mission performance through increased connectivity depot-wide. DLA will also replace Radio Frequency (RF) equipment at the Susquehanna, PA and San Joaquin, CA depots to maintain and support the mobility of the DDC's workforce. Software development investments are for System Change Requests (SCRs) for the Distribution Standard System (DSS). The FY 2003 investment will also include three SCR's necessary to DSS to interface with Business Systems Modernization (BSM). In addition, the Distribution Planning Management System (DPMS) will provide process integration to evaluate and optimize, at a global level, transportation operations. DPMS will integrate information about transportation rates, routes, carrier capacities and customer service requirements in order for the DDC to better manage asset visibility and cost. In FY 2003, the Minor Construction budget remains relatively constant from the previous year.

Operating Result. FY 2003 distribution rates are based on full cost recovery. We project an AOR of zero by FY 2003. We are projecting no losses for the budget year. The $.5 million gain in FY 2003 will recover a small FY 2002 loss.

NOR/AOR
($ in Millions)

	FY 2001	FY 2002	FY 2003
Revenue	$1,209.9	$1,200.2	$1,250.2
Expenses	$1,221.8	$1,274.3	$1,286.6
Operating Result	(11.9)	(74.1)	(36.4)
Other Changes Affecting NOR	0.0	0.3	36.9
NOR	(11.9)	(73.8)	.5
Prior year AOR	85.2	73.3	(0.5)
Non-Recoverable Adjustment Impacting AOR	0.0	0.0	0.0
AOR	73.3	(0.5)	0.0

DEFENSE LOGISTICS AGENCY
Defense-Wide Working Capital Fund
Distribution Depots Activity Group
FY 2003 Budget Estimates
Changes in Cost of Operations
(Dollars in Millions)

		EXPENSES	
FY 01 Estimated Actual		1,324.3	
FY 01 Actual		1,221.8	
Estimated Impact in FY 02 of Actual FY 01 Experience:			
Depreciation		4.1	
Personnel Costs		6.0	
Supplies and Material		2.3	
Travel and Transportation of Personnel		0.9	
Transportation		(37.6)	
Interfund Purchases		2.7	
Other Services		(27.5)	
Pricing Adjustments:			
Annualization of FY 01 Pay Raise		4.2	
FY 02 Pay Raise		15.7	
General Purpose Inflation		12.8	
Program Changes:			
BRAC		(14.4)	
Non Capital IT		(1.6)	
A-76 Competitions		(3.1)	
Workload Decrease		(14.5)	
FY 02 Current Estimate		1,274.3	

Exhibit Fund-2 Changes in the Costs of Operation
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Defense Logistics Agency
Defense-Wide Working Capital Fund
Distribution Depots Activity Group
FY 2003 Budget Estimates
Source of New Orders and Revenue
(Dollars in Millions)

	FY 01	FY 02	FY 03
1. New Orders			
a. Orders from DoD Components:	52.2	46.5	47.1
Other Services (Appropriated)			
DLA	10.0	3.0	2.5
Army	21.8	23.3	25.1
Navy	0.0	0.0	0.0
Air Force	1.1	0.0	0.0
Marine Corps	0.0	0.0	0.0
QOL	2.8	4.1	3.5
DDMA	16.4	16.1	16.1
b. Orders from Other Working Capital Fund Activity Groups:	1,157.7	1,153.6	1,203.0
DLA	595.7	596.0	613.6
Army	234.5	211.4	242.0
Navy	138.0	146.9	146.8
Air Force	184.6	194.0	193.4
Marine Corps	5.0	5.3	7.2
c. Total DoD:	1,209.9	1,200.2	1,250.2
d. Other Orders:	0.0	0.0	0.0
Other Federal Agencies			
Trust Fund			
Non Federal Agencies			
Foreign Military Sales			
2. Carry-In Orders	0.0	0.0	0.0
3. Total Gross Orders	1,209.9	1,200.2	1,250.2
4. Funded Carry-over	0.0	0.0	0.0
5. Total Gross Sales	1,209.9	1,200.2	1,250.2

Defense Logistics Agency
Defense-Wide Working Capital Fund
Distribution Depots Activity Group
FY 2003 Budget Estimates
Revenue and Expenses
(Dollars in Millions)

	FY 01	FY 02	FY 03
Revenue:			
Gross Sales	0.0	0.0	0.0
Operations	1,175.2	1,149.6	1,207.0
Capital Surcharge	0.0	0.0	0.0
Depreciation excluding Maj Const	34.7	50.6	43.2
Other Income			
Total Income:	1,209.9	1,200.2	1,250.2
Expenses:			
Cost of Material Sold from Inventory	0.0	0.0	0.0
Salaries and Wages:			
Military Personnel	10.7	11.9	10.7
Civilian Personnel	410.6	495.7	521.7
Travel & Transportation of Personnel	6.7	8.0	7.7
Materials & Supplies (for Internal Operations)	49.0	32.1	31.3
Equipment	2.1	2.2	2.0
Other Purchased Services from Revolving Funds	49.8	50.0	41.0
Transportation of Things	398.1	386.1	385.3
Depreciation-Capital	34.7	50.6	43.2
Printing and Reproduction	1.2	1.2	1.3
Advisory and Assistance Services	5.0	5.2	2.9
Rent, Communication, Utilities, & Misc. Charges	10.6	8.0	6.8
Other Purchased Services	243.3	223.3	232.7
Total Expenses	1,221.8	1,274.3	1,286.6
Operating Result	(11.9)	(74.1)	(36.4)
Less Capital Surcharge Reservation	0.0	0.0	0.0
Plus Appropriations Affecting NOR/AOR	0.0	0.3	36.9
Other Changes Affecting NOR/AOR*	0.0	0.0	0.0
Net Operating Result	(11.9)	(73.8)	0.5
Prior Year AOR	85.2	73.3	(0.5)
Accumulated Operating Result	73.3	(0.5)	(0.0)
Non-Recoverable Adjustment Impacting AOR	0.0	0.0	0.0
Accumulated Operating Results for Budget Purposes	73.3	(0.5)	(0.0)