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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES DIVISION

FEBRUARY 26, 1980

B-197773

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The Honorable Max Cleland
Administrator of Veterans Affairs 16

Dear Mr. Cleland:

Subject: Planned Expansion of Hines Supply Depot Has Not Been Justified (PSAD-80-31) AGC 00989

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The Veterans Administration (VA) Supply Service, Department of Medicine and Surgery (DM&S), is planning to expand the Hines Supply Depot to meet projected inventory increases. Provisions for this $8.8 million project are included in VA's 1981 budget proposal and construction is slated for 1981.

Having reviewed supporting documents and interviewed VA officials, we believe the Department has failed to demonstrate that the depot's needs will soon exceed its capacity or that expansion would be the best solution to such a problem. Therefore, we recommend deleting the depot expansion project from VA's 1981 budget proposal.

In projecting a need for more space, DM&S neglected to

--consider the impact of the increased emphasis on the Federal Government's "buy commercial" policy,

--obtain pertinent information from the VA Marketing Center, and

--use reliable indicators of inventory growth.

In planning an expansion as the solution to the alleged space problem, DM&S neglected to

--adequately assess alternatives, such as reducing inventory levels, leasing space, or reallocating inventory, and

--fully consider important cost factors, such as inflation and capital costs.

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BACKGROUND

The supply depot at Hines, Illinois, is one of three responsible for storing and distributing medical supplies and food to VA medical centers and other Government facilities. The Hines Depot stores and distributes items for 76 medical centers and 150 other Government facilities. Because VA officials believe sales and inventory levels will grow beyond the depot's capacity, they plan to expand it.

VA hired a private consultant to calculate future warehouse space requirements and design a new depot complex to meet VA's projected growth. The resulting expansion project includes

--adding 82,000 square feet of storage space,

--altering 14,000 square feet of space,

--separating receiving and shipping by adding a dock area,

--additional air conditioning equipment for drugs and refrigerated items, and

--implementing an automated handling system.

For many years VA has predicted that the Hines Depot would run out of space. In the late 1960's, VA's long range plans indicated a need to start depot expansion by 1975. In 1975, VA estimated the depot would run out of space sometime between 1977 and 1978. By 1976, the expected overflow was pushed back to 1979. Current predictions are that the depot will not have sufficient storage space in 1981.

So far, VA's predictions have not materialized. Some operating adjustments have been made, but the depot has never rejected a shipment because of space shortages. Furthermore, there is no indication that service to medical centers or to other Government agencies has been hampered because of limited depot space.

IS MORE SPACE REALLY NEEDED?

"Buy commercial" policy not considered

The Office of Federal Procurement Policy has requested agencies to rely more on commercial supply sources and distribution channels than on in-house storage facilities.

In December 1976, the Office informed the Administrator of Veterans Affairs that:

> "Warehouse inventories of commercial products under this program will be drawn down in favor of direct commercial distribution and support to the user. A progressive but nondisruptive phaseout must be accomplished when converting from Government to commercial distribution channels." (Underscoring supplied)

Implementing this policy should affect VA's depot requirements. As a matter of fact, in 1976 VA's Construction Review Board voiced this concern, but the Supply Service responded that the policy's impact was unknown and "several years in the future."

However, policy implementation is now affecting VA's supply operations. In October 1979, for instance, VA officials told us they had reduced the number of centrally managed stock items as a direct result of their efforts to implement the policy. These reductions were not considered in VA's depot growth projections.

Marketing Center input not obtained

VA's analysis of depot space had limited Marketing Center involvement. The Hines Depot is responsible for storing, controlling, and distributing VA's centrally stocked items, but the Marketing Center is responsible for determining what, how much, and when supplies enter the Hines Depot. Specifically, the Center's duties include selecting depot stock items, managing inventory levels, procuring goods, and scheduling shipments to the depot.

In these critical supply duties, the Center directly influences the depot's inventory level. Yet VA records and our discussions with VA officials indicate the Marketing Center provided little, if any, input to the space assessment. Officials claim information was exchanged, but their discussions were never recorded. We believe the Marketing Center should have had more input.

Unreliable indicator of space needs used

Projected dollar growth by itself is an unreliable indicator of space needs, and VA should not have used it since it can be influenced by inflation and commodity mix. Using cost data from 1967 through 1975, VA demonstrated a need for additional space by projecting the dollar values of sales and inventory for 1978 through 1985. By relating dollar values to physical space, VA estimated that growth would eventually exceed capacity. VA acknowledged that increases in dollar values result partly from inflation; thus it discounted each year's projected growth increase by 5 percent. However, a constant factor of 5 percent understates the inflationary effect. For example, during the period of VA's study (1967 through 1975), the Consumer Price Index for nonperishable foodstuffs rose over 78 percent.

Also, overall dollar values do not portray the storage requirements of each commodity group. For example, every dollar of foodstuffs requires about eight times more space than a dollar of drugs or medical supplies. Furthermore, inventory levels of each commodity group may rise or fall. The value of VA's total medical supplies inventory, for example, increased 72 percent from 1974 to 1975 and dropped 6 percent in 1976.

A more reliable approach to assessing space needs is through the actual space used by each commodity group. VA agreed that utilization data is better than cost for projecting space needs, but indicated that resources were not readily available for this type of assessment.

IS EXPANSION THE BEST SOLUTION TO A SPACE PROBLEM?

Some alternatives were not fully considered

In concluding that expanding the Hines Depot would be the most economical way to meet its projected need for more space, VA addressed some other options:

--Doing nothing.

--Reallocating inventory overloads to other VA depots.

--Using a second workshift at the depot.

Options that have merit, but were not considered, include

--reducing inventory levels and

--leasing external storage space.

Depot inventory turns over three to four times a year. In June 1976, we reported 1/ that this turnover rate was too low, and that it tied up storage space and added to costs.

VA purchases much of its food directly from the canner during the "annual pack season." This enables VA to obtain favorable prices, since the canners do not incur inventory costs. For the most part, this practice results in an entire year's supply of canned goods being delivered to VA depots between September and December each year. VA believes, but has not proven that savings from "annual buys" offset the additional storage and handling costs. Flexibility in applying this concept, however, could make more depot space available. Before deciding on expansions, VA should explore this alternative.

In 1978, when additional storage space was needed at Bell Depot, VA leased additional storage space from GSA. While there may be differences between Hines' and Bell's operations, the possibility of leasing space for Hines should be considered.

In the past, VA has reallocated depot workloads. VA's cost study addressed the reallocation of inventory workloads between depots. However, this alternative was not selected because VA determined it would require transferring personnel at a substantial cost, without fully assessing this cost. We believe depot reallocation warrants further consideration, particularly in view of the flexibility it may offer in meeting future workload changes.

Critical cost factors omitted

VA's analysis omitted critical cost factors that might have altered its decision. Although, Office of Management and Budget (OMB) Circular A-76 provides criteria for comparing costs, VA's analysis did not follow these guidelines.

A critical OMB cost factor that was omitted from VA's analysis was the "cost of capital," or the Government's cost to finance the expansion. Using a 10-percent rate, as prescribed by OMB, would have increased VA's estimated "marginal cost of expanding" the Hines Depot from $272,000 to $572,000. Since depot expansion was the only alternative involving a capital investment, excluding this factor distorted VA's cost analysis.

1/MWD-76-133 dated June 3, 1976.

Another cost factor not fully considered was inflation. Utility expenses associated with the proposed expansion, for example, did not include an inflation factor. This is inconsistent, since VA used an inflation factor for projecting depot growth and costs for the other alternatives considered.

Other cost factors were omitted, but these two, inflation and capital investment, would have been sufficient to make depot expansion no longer the least costly solution among alternatives considered.

RECOMMENDATIONS

Because neither the need for more space nor the superiority of expansion as an answer to that need has been demonstrated, we recommend that the Administrator of Veterans Affairs direct the Chief Medical Director, DM&S to

--delete the Hines Depot expansion project from the 1981 budget request,

--reassess Hines' need for space, considering the impact of the "buy commercial" policy, consulting with Marketing Center officials, and using reliable indicators of growth, and

--if the need for more space can be demonstrated, fully assess alternate solutions, considering all cost factors.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions he has taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Copies of this report are being sent to the Chairmen of the House Committees on Appropriations, the Budget, Government Operations, and Veterans' Affairs; the Chairmen of the Senate Committees on Appropriations, the Budget, Governmental Affairs, and Veterans' Affairs; and to the Director, Office of Management and Budget.

We would appreciate being informed of any actions taken or planned on the matters discussed in this report.

Sincerely yours,

Edward A. Densmore

for Gregory J. Ahart
Director