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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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NOV 27 1973

The Honorable Adlai E. Stevenson, III
United States Senate

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Dear Senator Stevenson:

Your May 14, 1973, letter requested us to review the Department of the Navy's proposed plan to merge its Electronics Supply Office (ESO), Great Lakes, Illinois, with its Ships Parts Control Center (SPCC), Mechanicsburg, Pennsylvania. In a subsequent meeting at your office, we agreed to specifically consider the following questions in our review.

--Did the Navy consider all pertinent costs, such as severance pay and moving expenses, in its estimate of savings to be realized by the merger?

--Did the Navy consider letting ESO absorb the positions to be eliminated?

--Can there be savings if, at a later date, the Navy adds at SPCC the positions eliminated at ESO?

--Will current efficient interface with suppliers be affected?

--Are management functions similar enough so that SPCC can absorb items being transferred from ESO?

--Will the cost to manage ESO items increase after transfer to SPCC?

The Navy's decision to consolidate ESO with SPCC was not based on formal cost-savings analysis. The Navy did develop estimates of savings to be realized by the merger which were prepared for planning purposes only. These estimates were based on certain assumptions--the principal one being the elimination of 190 personnel positions. Because of the lack of documentation to support the Navy's assumptions, we cannot precisely evaluate the overall effect of the proposed merger.

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In summary, however, it appears that, if consolidating Navy inventory control points were desirable, ESO was the most logical installation to move, primarily because of its relatively small size. Also an ESO study indicated that the merger's effect on the Cook and Lake Counties' economies would apparently be minimal.

As you know, the Navy is currently going ahead with the merger as planned.

BACKGROUND

In a May 10, 1972, memorandum, the Deputy Chief of Naval Operations directed the Chief of Naval Material to investigate the possibility of merging Navy inventory control points. On May 10, 1972, the Naval Shore Establishment Realignment Group, an ad hoc group under the direction of the Chief of Naval Operations, requested a consolidation recommendation from the Naval Supply Systems Command.

During the next 2 weeks, officials of the Supply Operations and Fleet Support Office, within the Naval Supply Systems Command, considered reducing the number of inventory control points from three to two. We were told that, because of the sensitive nature of this project, no other officials in the Naval Supply Systems Command or the inventory control points were consulted. The requested information was submitted on May 25, 1972, to the Shore Establishment Realignment Group.

On the basis of this information and additional information provided by telephone conversations, the Shore Establishment Realignment Group approved a proposal to merge ESO with SPCC. The proposal was submitted through the Chief of Naval Operations to the Department of Defense (DOD) and was subsequently included in DOD's base closure and merger actions officially announced on April 17, 1973. A Navy official said that the Naval Supply Systems Command did not know about the final decision to merge ESO and SPCC until DOD's announcement.

On May 11, 1973, SPCC submitted an ESO-SPCC consolidation plan to the Naval Supply Systems Command. The plan included target dates for specific merger actions and a proposed organization structure for the consolidated activity. The plan, however, did not identify costs savings associated with this action or the 190 positions which the Naval Supply Systems Command indicated would be eliminated. Although Navy officials said that at least 190 positions would be eliminated, they did not provide any supporting documentation. This action, they said, was in anticipation of future budget cuts.

The basic responsibility for the three Navy inventory control points--the Aviation Supply Office (ASO), SPCC, and ESO--is to provide supply support to meet Navy supply demands. The control points manage inventories but do not stock them.

The relative sizes of the inventory control points as of June 30, 1973, follow.

	ESO	SPCC	ASO
Number of authorized positions:			
Military	34	77	74
Civilian	[a]750	2,673	1,971
Number of items managed	112,719	238,307	378,345
Value of inventory managed (billions)	$0.423	[b]$1.03	$2.77
Fiscal year 1973 gross operating expenses (millions)	$11.8	$41.9	$30.3

[a]Includes 20 positions added in 1972 to support the Trident Submarine program. These positions were not funded by ESO and were not included in the Navy's cost estimates for the merger.

[b]Does not include ammunition items valued at about $1.5 billion.

ESO MOST LOGICAL CONTROL POINT TO RELOCATE

Naval Supply Systems Command officials considered various ways of consolidating the inventory control points. Their primary reason for selecting ESO for elimination was its small size in comparison with the sizes of the other inventory control points. Apparently ESO was considered the most feasible because the Navy could not attain equal savings by eliminating either ASO or SPCC. Furthermore, ASO was excluded from further consideration because it is responsible for managing aircraft parts and equipment which, according to Navy officials, is considerably different from managing parts and equipment for ships. The Navy said that, although ESO and SPCC manage different types of equipment, they both manage items for ships which provides a degree of commonality and therefore they were considered the best consolidation possibilities.

Using conservative cost estimates, we determined the payback period[1] for consolidating SPCC with ESO. Assuming equal

[1]The length of time it would take to recover from savings the costs associated with the relocation.

savings, if SPCC were to be moved to ESO, the payback period would be more than double that calculated for moving ESO to SPCC. Along similar lines, we determined that almost three times as many positions would have to be eliminated from the consolidated activity at Great Lakes to obtain the same payback period.

It appears, therefore, that ESO was the most logical inventory control point to recommend for relocation.

ESO EMPLOYEES GIVEN MAXIMUM CONSIDERATION

Naval Supply Systems Command officials said that they gave maximum consideration to ESO's employees. Therefore, during May 1973, transfer offers were extended to all 730 ESO employees. If all ESO employees had accepted transfers, few would have been given jobs in a lesser capacity because of the large number of anticipated retirements at SPCC. Current SPCC personnel reports show that 313 employees retired during the last half of fiscal year 1973.

MERGER WILL COST ABOUT $7.7 MILLION

The Navy's initial cost estimate of the merger was $6.3 million, which included $4.2 million in personnel-related costs and $2.1 million in site preparation costs. The payback period for these costs was approximately 4.8 years. After the initial estimate, the Navy identified additional costs totaling approximately $1.4 million. Thus their current estimate indicates that costs will total about $7.7 million.

The $1.4 million increase includes the cost of relocating equipment, adding temporary activity duty travel for employees, consolidating ESO and SPCC computer data bases, and renting commercial office space.

Navy officials said that additional office space would be needed for a time, depending on progress of the $2.1 million proposed construction, and that they were negotiating with the State of Pennsylvania for space at the prior site of Olmstead Air Force Base. One Navy estimate for office space rental was $450,000. Because other parties were interested in obtaining this office space, the Navy may have to contract for the space before it actually needs it, these officials said.

SAVINGS ENTIRELY DEPENDENT ON ELIMINATING 190 POSITIONS

The Navy's estimated $2.2 million savings per year is based on eliminating an estimated 190 positions. A Naval Supply Systems Command official said that these positions would be eliminated primarily from overhead-type functions.

According to this official, the planning estimate of 190 positions was based on discussions with Navy officials who were aware of ESO's and SPCC's operations. According to another Navy official, an analysis was made of ESO's positions by functions to determine which positions could be eliminated. However, until the Navy identifies the positions for the combined ESO-SPCC activity, valid estimates concerning personnel savings cannot be developed.

Although the Navy has developed an organizational structure for the consolidated operation, it is not in sufficient detail to identify eliminated positions. An SPCC official said that the ESO employees who were transferring would not be given specific positions until they arrived at SPCC. However, the first 53 ESO employees transferred were offered their present grade and classification at SPCC.

NAVY COST ESTIMATES DID NOT COVER ALL PERTINENT COSTS

The Navy's original estimate for personnel-related costs was $4.2 million, including $3 million for severance pay and lump-sum leave, $820,000 for relocating ESO personnel to SPCC, and $400,000 in miscellaneous costs.

This $4.2 million estimate did not include all personnel-related costs the Government would incur as a result of the merger. For example, the costs associated with early retirements were omitted from the Navy's estimate as were costs to hire and train new personnel at SPCC to fill some of the 540 transferred positions.

The Naval Supply Systems Command originally estimated that, of the 730 ESO civilian employees, 130 would transfer to SPCC, 110 would retire, and 490 would either quit or obtain other employment. The Navy made these estimates on the basis of its experience; however, it did not give any documentation for the estimates. Current estimates show that 323 ESO employees have indicated a willingness to transfer and that 42 have retired.

Severance pay and moving expense

The original severance and lump-sum leave estimate of $3 million was calculated by multiplying 600 (730 civilian employees minus the 130 transferring to SPCC) times $5,000. The original relocation cost estimate of $820,000 was calculated by multiplying 164 (130 civilian employees plus 34 military) times $5,000, the estimate for moving one employee from ESO to SPCC.

Although the Navy indicated that both the severance pay and the relocation cost estimates per individual were based on historical data, it had no documentation substantiating either $5,000 estimate.

Early retirements and training costs

Early retirements resulting from closing Federal facilities may involve a substantial cost to the Government which should be recognized in computing the fiscal effect of such closings.

The Navy did not attempt to estimate the impact of these costs on the merger. Calculating such costs involves actuarial determinations based on the number of employees retiring and the status of the employees concerned, neither of which were determined.

Training costs also should have been included in the Navy's estimates. An SPCC official told us that after the merger approximately 240 new employees would have to be hired to fill some of the 540 transferred positions. We estimate that approximately 175 additional employees will have to be hired and trained as a direct result of the proposed merger. We attempted to estimate these costs, but the Navy had no information from which we could base our estimates. Therefore we do not know the significance of these training costs.

ESO COULD NOT ABSORB PERSONNEL CUTS

A Navy official said that, because of prior personnel cuts at the inventory control points, serious degradation of fleet support would occur if any individual inventory control point tried to absorb further personnel cuts. For example, ESO's personnel level had been reduced from approximately 1,100 employees in June 1969 to about 730 employees at the time of our review. Furthermore, during fiscal year 1972, ESO told the Naval Supply Systems Command that it could not absorb further personnel cuts without reducing its operating capability. Navy officials said that, if they eliminated 190 positions at ESO, it could no longer remain a viable activity.

NAVY DOES NOT INTEND TO ADD POSITIONS AT SPCC

Naval Supply Systems Command officials said that only 540 positions would be transferred from ESO to SPCC and that they did not plan to add any additional positions at SPCC after the merger. There is no guarantee, however, that the Navy will reduce its overall strength. We take this position because the Navy did not provide any documentation to support its assertion.

INTERFACE WITH SUPPLIERS NOT AFFECTED BY MERGER

The present working relationships the Navy has developed with its suppliers will probably be maintained after the merger. Most items ESO manages are procured on a bid basis; therefore, all suppliers receive the same opportunity to obtain Navy procurement contracts. Furthermore, according to Navy officials, interaction with these suppliers is conducted by either formal correspondence or telephone. The relocation of ESO to SPCC should not affect the relationships the Navy has with suppliers. Additionally, transportation costs should not be affected by the proposed move because ESO does not maintain any physical inventories.

SPCC CAN ABSORB AND MANAGE ITEMS BEING TRANSFERRED

Most of the positions directly involved in the management of supply items are being transferred to SPCC as functional units.

As mentioned earlier, most of 190 positions being eliminated are associated with overhead-type functions in the command, planning, data processing, and management divisions. Therefore SPCC should be able to absorb and manage items being transferred.

COST TO MANAGE ITEMS CANNOT BE USED TO MEASURE EFFICIENCY

The Navy has not attempted to compare the relative efficiencies of its inventory control points because of differences in (1) the individual costs of line items, (2) the management time required for individual items, and (3) the unique characteristics of the items managed.

The Navy made a study to show the cost of managing an additional line item added to the inventory. The costs did not represent the average cost to manage an item, and it was never intended they would be used to compare the relative efficiencies of ESO and SPCC.

The Navy subsequently found that the costs developed by the study were incorrect. Unrealistic cost projections resulted because the historical data used in the study covered a relatively short time.

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Although we did not obtain formal written comments from the Navy, we discussed our observations with appropriate Navy officials, and their comments were considered in the preparation of this report.

We trust this information will be helpful, and we shall be glad to discuss this matter in detail with your office. We plan no further distribution of this report unless you agree or make public it contents.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States