

WORKING CAPITAL FUNDS

12 January 1954

1167

CONTENTS

	<u>Page</u>
INTRODUCTION--Colonel R. W. Goldsmith, USA, Member of the Faculty, ICAF.....	1
SPEAKER--Brigadier General Alfred V. Denniston, USA, Deputy for Administration and Comptroller, Office of the Quartermaster General, Department of the Army.....	1
GENERAL DISCUSSION.....	12

NOTICE: This is a copy of material presented to the resident students at the Industrial College of the Armed Forces. It is furnished for official use only in connection with studies now being performed by the user. It is not for general publication. It may not be released to other persons, quoted or extracted for publication or otherwise copied or distributed without specific permission from the author and the Commandant, ICAF, in each case.

Publication No. L54-78

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D. C.

Brigadier General Alfred B. Denniston, USA, Deputy for Administration and Comptroller, Office of the Quartermaster General, Department of the Army, was born in Mt. Pleasant, Pennsylvania, 27 September 1904. He was promoted to his present rank on 28 July 1953. He is a graduate of the U. S. Military Academy, 1928; the Quartermaster Corps Motor Transport School, 1930; and the Quartermaster School, 1939. In addition he received his M.S.E. from the College of Engineering, University of Michigan, 1933. Originally commissioned in the Quartermaster Corps, he was detailed to the Air Corps and the Infantry for short periods. At the outbreak of World War II, he was assigned as Motor Transport Officer, Hawaiian Department. In February 1942, he was transferred to be Assistant AC/S, G-4 at the same headquarters, from which duty he returned to the United States in June 1943. Upon arrival he was assigned as Assistant AC/S, G-4, Headquarters, Army Ground Forces. He returned overseas and was assigned the following duties: 1 January-31 August 1945, Assistant AC/S, G-4, ETO; 31 August-31 October 1945, Office of the Chief QM, USFET; 1 November-31 December 1945, D/C QM, USFET; and 1 January-1 August 1947, CS, American Graves Registration Command, Europe. Since returning to the United States in August 1947, he has had the following assignments: August 1947-July 1948, student at the Industrial College of the Armed Forces; July 1948-July 1950, Chief, Office of Procurement, Munitions Board; July 1950-May 1953, staff and faculty, Army War College; and since May 1953 his present duty. This is his first lecture at the Industrial College.

WORKING CAPITAL FUNDS

12 January 1954

COLONEL GOLDSMITH: Admiral Hague, gentlemen: This morning you are going to hear the third in a series of four lectures in direct support of your study on "Distribution Logistics." Last week you heard from Mr. Thomas on the "Department of Defense Supply System." You will recall that he emphasized the necessity for sound and efficient supply management. Our speaker today is going to explain some of those tools which are necessary to attain this goal. Specifically, he will discuss those funding operations which are an essential part of the business of supply management.

Brigadier General Alfred B. Denniston, as Deputy for Administration and Comptroller, Office of the Quartermaster General, Department of the Army is in this business. You have read his very fine record of military service. It is my privilege to introduce an associate of 25 years' standing and to welcome back to this college a rather recent alumnus, General Alfred B. Denniston, Department of the Army, who will talk to you on the subject, "Working Capital Funds." General Denniston.

GENERAL DENNISTON: Thank you, Roger. Admiral Hague, General Greeley, that greatest blessing a speaker can have, my captive audience: It is an honor to be asked to speak to the Industrial College, but, to me much more important, it is a great pleasure to come over here and discuss, I think, an important subject with a very fine group of my old friends. I don't think I could find an audience anywhere where there would be more fine old "friends" of mine.

If the college had wanted a learned technical discussion of working capital funds, it would have invited one of the many experts in this field. He would have shown you 18-foot charts depicting the gestation of a voucher from the pleasurable incurrence of the liability to the cruel denouement of the disbursement. He would tell you that there is much waste motion in that process, that vouchers should be born with all the dotted lines signed--frequently by people who know little enough about the realities of the events that had taken place.

It is important that vouchers, payrolls, and other documents be processed with a minimum of "red tape." It is more important, though, that the Navy get its ships, the Air Force get its planes, and the Army and the Marine Corps get their tanks and guns in the proper quantity and proportion--at the minimum cost to the taxpayer.

"Working capital funds" are an important, perhaps a vital, element of the Department of Defense's improvement of financial management. If I sound a note of caution, it is because I believe firmly in the benefits to be gained from our "Working Capital Fund" programs. It is important, however, that we keep the emphasis on the primary objectives of the exercise. It is important, that while getting every conceivable benefit from these programs, we do not expect results from them for which they are not designed and which they cannot produce.

I will discuss briefly--as briefly as it is possible for me--stock funds and industrial funds. I shall mention a third fund only so you won't think I am not conscious of its existence, that is, a management fund. A management fund is not a working capital fund so I shall eliminate that from the discussion. Furthermore, I don't know enough about it to talk on it. In addition, I will discuss some related budget activities and anyone who does not think that budget activities are interwoven with working capital funds and that working capital funds are interwoven with budget activities has not had the dubious pleasure of trying to defend a stock fund budget the first time that it has been presented to reviewing authorities.

First, to define what we are talking about--stock funds are revolving funds of working capital, used to finance the acquisition and holding of common-use types of materials and supplies. The cost of such materials and supplies, requisitioned for consumption, are charged to the requisitioning activities and the stock fund is reimbursed therefor. In other words, the stock fund finances all elements of the "pipeline inventory" from approved requirements to the point of issue for consumption purposes.

The second, industrial funds, are revolving funds used to provide working capital to finance commercial-type operations of industrial and service type activities, which produce or furnish goods or services. This working capital includes the usual type of current assets of private enterprises.

These two types of funds, stock funds and industrial funds, have many things in common. As a matter of fact, I will spend most of my time on stock funds and will not bore you by repeating the things about industrial funds I have already said about stock funds. Each, however, must be tailored to a specific operational need.

Now as to historical background--I can't look around and tell from your clothing the service you represent, but I know many of you normally wear navy blue and to the Navy stock funds are an old story. Stock

funds have been operated by the Navy and have supported considerably its stock operations through three wars. To the Army and Air Force they are a relatively new tool of management.

The modern emphasis on working capital funds gets its basis from the report of the Hoover Commission on the organization of the executive branch of the Government--that is the first Hoover Commission, not the one just getting under way. That report found that the Department of Defense budget and financing was too complex, was based on people and things rather than on work to be done; the accounting and reporting was inadequate; and there was no basis for the analysis of the utilization of assets.

Stemming from that report came certain portions of Public Law 216, 81st Congress, generally known as the 1949 Amendments to the National Security Act. This statute authorized working capital funds to the Army and Air Force and possibly changed the rules somewhat and re-emphasized them as far as the Navy was concerned.

Two sections of the law did two other things. They required of the Army and Air Force, as well as the Navy which already had it to a considerable degree, "Financial Property Accounting." That is, we had to put a dollar sign on our inventories in addition to keeping track of them by item and quantity. It required performance budgeting; in other words, figuring out your program and laying out your budget to support that program.

The hours spent, so far as the Army is concerned, on working capital funds have been long and tedious. As I noted, the basic statute was passed, if I recall correctly, in August 1949. As of 1 January 1954, the Department of Defense regulations covering working capital funds were not published. I am informed that since then they are in the hands of the printer. You can see that from August 1949 to January 1954 is quite a while to wait for the publication of such important regulations.

In my opinion the benefits to be derived from working capital funds will be in direct proportion to the attitude of all concerned with them. I have taken the attitude, as have my people, and I think the majority of the people in the Army concerned, that working capital funds are here to stay. It doesn't make one bit of difference whether you and I like them, whether the Quartermaster General likes them, or whether any of his associates likes them. They are the law of the land, and it is not going to be changed, in my opinion.

As I said, they are new to the Army and the Air Force; they have been broadened and re-emphasized to the Navy. If we are going to be

successful in their operation, the basic principles must be understood by all, explained at all levels, and accepted by all concerned. That will mean the uprooting of some deep-seated policies. It will mean the change of some basic principles. It may even cause a certain rearrangement of some of our fondest prejudices. This adjustment to new conditions must be happily made.

Does it require a reorganization? Do we have to revamp our command structure? I think "No." I think that all we need to do is to readjust our thinking and our approach to certain things that we have become accustomed to doing in the same old way.

Now, while I speak of attitude, there are--and you will find it within the military and within, maybe, some of the civilian sections of the Government--several attitudes to working capital funds. There are the people who are all for them; there are people who are all against them; then there is another group of people who remind me of the young man who had just seen his mother-in-law drive his brand new big car over a cliff--they view them with mixed emotions.

Working capital funds are not a cure-all. They are a management tool which will help the operator to do a better job of supplying his customers. And I would like to emphasize that they are a management tool for bottom management as well as top management. I think too many of us think that the reports and statements and the analyses which come out of the operation of working capital funds are meant only for the top people over in the Pentagon, which might even include some of these technicians I referred to, experts, leaders, and for the Bureau of the Budget, and even higher. Nothing could be further from the truth. Their greatest value comes in the information they give to operators and managers at the lowest level. They furnish vital information, which, if properly evaluated, will improve our supply system no end.

Dollar data will not replace or supplant item or quantity data. Together, your item and quantity data and your dollar data will tell you where you have been, where you are, and will lay out certain patterns that you may follow. At that point the accountant--accounting techniques or system formulae--step out and command and the operator--the manager--takes over. It is his responsibility from then on.

I think if I may, and if I don't use my Navy terminology correctly, I will give Admiral Hague a few minutes in the discussion period to straighten me out, we might liken it to the relationship between the navigator on a ship and the skipper. The navigator accumulates vital information, establishes the present position, presents it to the

captain who is responsible for setting the proper course. He tells the skipper right where they are, gives him all the information as to what is ahead in all directions, but the skipper gives the directions of the course.

We accountants, we technical people, do very much the same thing. So far as we are concerned in the Office of the Quartermaster General, in our operations, these data are turned over to my colleague, General Evans, Deputy for Operations, and he and his people decide what action we are going to take.

We must never forget that the business of a supply service is the delivery of goods--to use a trite old expression--at the right place, at the right time, in the right quantity. There is no substitute for that.

Dollar data--I might use as an example--will give a signal that something is wrong. For instance, I might read a report showing we are 10 million dollars over in shirts. That tells me there is something wrong. But I have to get into the sizes, the distribution, and everything else of that overage as well as my normal dollar value of stockage before I can tell what is wrong. I may find that I am still short of shirts because, in spite of having 10 million dollars more than I need, I have no 36/15, and to a man who wears size 36/15 that 10 million dollars worth of other sizes isn't worth an iota.

At this point I have decided that I will assume you want to establish a stock fund. We will start with that. Your first chore is to determine whether the items and categories of items that you are concerned with are adaptable to a stock fund; beyond that, whether or not the operation of a stock fund will improve the supply of those categories.

Now, basically there are three simple questions to be answered. This doesn't give you the whole answer but it will certainly give top management a pretty good idea: Is there a definite recurring demand for that category of items which people are going to keep on wanting--or approximately the same thing--year after year. Examples of that could be tanks, shoes, drugs, and food. Note that tanks meet our first category--as far as we know for a long time we are going to need tanks and they will be reasonably the same.

Is that category under "central item inventory control?" Again our four examples, tanks, shoes, drugs, and food are all, so far as we know, in all services under central item inventory control.

Is it stable or are they stable, not having a high obsolescence rate? Food, drugs--to a degree--and shoes meet that, but tanks do not. Tanks are not stable; they are constantly improved. I wouldn't stock so heavily on them and figure on just turning that stock over and over year after year. So we would eliminate tanks.. Along with that, we would eliminate aircraft, ships, and many other things.

One of the things that I think is the best example--and I hope that since I last checked nobody has put it into the stock fund--is aeronautical spare parts. If you put aeronautical spare parts into the stock fund at the rate at which airplanes become obsolete and at the rate you have parts left on the shelves for which you no longer have an airplane, you are going to lose a lot of money in your stock fund. It just doesn't fit.

Now you have decided that your category is suitable and beyond that there are advantages--let us emphasize that. Let us not have stock funds or anything else just because it will work. Let us make each category prove itself--that is to the degree that you and I can--never that you are ready to establish or capitalize your stock fund.

The first thing that you as a good businessman, starting into business must do is to determine what are your assets? Your assets are your stocks on hand and due in, that you have already obligated the money for; they are coming in; they are going to be in your possession. Now you must screen those for obsolete items. You don't want to capitalize into your stock fund those things that you are going to have to throw away or sell at bargain counter prices in the near future.

Many experts tell me that is not necessary because throughout the Department of Defense every chief of a technical service and comparable people in the other departments must certify that they just don't have any surpluses and excesses. Well, you and I know that, despite all certification, excesses and surpluses can develop overnight. Something awfully valuable, today can be worth not a nickel tomorrow due to a change in a part or change in design. So purify it; don't take a lot of assets today into your stock fund that will become liabilities tomorrow.

Then you determine your liabilities. I could go into some detail about that but it is not too technical for you; it is too technical for me. You determine then your net assets in money value. Of course, you priced your inventory. You know exactly how many dollars worth you have in stock and due in. After you have done that, you transfer that to the capital in your stock fund, and you are in business.

You lack one thing. You have a lot of capital but it is all in inventory. From somewhere you must get some cash capital so that you can continue purchasing, continue replenishing your stocks considering the lead time, while you wait for customers to come around and lay cash on the line. That, from our experience, is obtained from unobligated balances, in our case, available not to the Quartermaster General but to the Department of the Army.

Then, one final note of caution. When you plan a stock fund, if possible, plan well in advance, and if higher authority will permit, start it on 1 July. I needn't tell anyone here the advantage of starting a new business on 1 July because that is when you get new money and you can make a fresher, cleaner start.

Now you are in operation presumably. The Congress has appropriated funds for what we call a consumption budget. The consumption budget is different from the old type budget we are all much more used to which my men tell me is called a balancing budget. A balancing budget was one which on the first of July you got appropriated from Congress and it was apportioned down to you--probably not nearly as much as Congress appropriated--but some of it got through the chain and was apportioned down to the man who had to pay the money to buy the things that you wanted to procure, that you wanted to start action on during that fiscal year. You would still be paying for it, you would still be getting delivery on it one, two, or three years hence, but it was the money to be obligated during that fiscal year.

A consumption budget is in effect a budget in which the Congress appropriates to the customers the money they require to buy during that fiscal year off the already established shelves of their suppliers. That can be made much more complicated, but to me that is all there is to it.

So you are in business. You have the inventory; you have the supplies; and I hope you have figured well and you have the right ones. Your customers have cash to come in and buy. You have cash to get you started so that your long lead-time items can be purchased and can be coming in, pending this available cash from your customers.

You sell at standard current replacement cost, which is the market cost, plus first destination transportation--that is, the transportation to get it into the depot system, into your warehouses--and your inventory adjustment cost. It is very important to add that inventory adjustment cost. That is what takes care of your losses. It would be just as foolish for us not to do that as it would be for Sears-Roebuck in their sales price to ignore the fact that in their processing, after they have paid for it, some of their merchandise gets lost or damaged. If that is

not passed on to the customer, they would lose a tremendous amount of money. If we don't pass it on to the customer, our capital would shrink and we would not be in business very long. You exclude administrative costs and interest on investment and other things a business has to include.

On your pricing policy, the basic philosophy of maintaining the integrity of the fund will be to preserve its ability to meet item demand rather than to sustain a fixed dollar body. Expressed in dollars, the body would increase with high prices and decrease with low prices, but would remain level in terms of quantities, or the dollar equivalent of quantities, at current market levels. Obviously, this philosophy will require that issue or sales prices closely follow market prices. In effect, we can pretty well boil that down by saying we must maintain our purchasing power. If we don't, we will have the peculiar situation in which Congress has appropriated money to our customers to buy things off our shelves and we have mismanaged so badly that we don't have the stuff on the shelves to sell them. They would no longer be captive customers. I think they would find some way of taking their money and finding somebody who knew their business.

The application of stock funds now is rather limited in scope. It extends only to include the continental United States depots. Currently it excludes stocks at posts, camps, and stations and overseas. At the present time, when a continental United States depot ships out an item, it bills the customer for it and then picks up the cash. You can see that that leaves a big gap in our total operation.

I don't know what percentage--I have seen it recently; you can ask in the question period and somebody will answer approximately what percentage of our stocks, speaking quartermasterwise--are in such overseas posts, camps, or stations. We are in the process of working out how to extend the stock fund for bulk stocks to posts, camps, and stations and will include overseas bulk stocks, in which case the items will be in the stock fund until they are issued to the consuming organization or activity, which will give us naturally a much better picture of how we stand.

Along with that, will proceed an operation known as station funding, in which stations in which our customers will be funded will have the money instead of the depots holding it and in effect doing the bookkeeping for them. That has not been settled within the Army. We don't know just how that will work out and it presents some real problems to us.

Now, for just a short look at industrial funds--industrial funds are applied to commercial industrial-type activities. At the present

time the Army has a number in operation and many more are planned. Currently in operation is the Chemical Corps at the Rocky Mountain Arsenal, the Manufacturing Division of the Philadelphia Quartermaster Depot, and the Maintenance Division of the Jeffersonville Quartermaster Depot, and a number of others. Planned for inclusion in the future are Army laundries, bakeries, and coffee roasting plants.

The laundries present us with a peculiar problem in which you might be interested. You probably know that the Army operates laundries all over the world but charges the enlisted man the same price to wash a shirt no matter where that shirt is washed. We feel that that is very important, that he not have to pay a high price one place and get very inexpensive laundry in another. That requires, all these laundries, in effect, to operate as a unit, pricewise at least, the net result of which is that a large laundry with a large volume of business can make a considerable profit at the price charged; it then subsidizes the small laundry that cannot even pay its own cost due to the lack of volume.

There are other considerations. There are some laundries on closed posts or partially closed and they are too big. There is a lot of machinery that is idle. We will have to find some way, if possible, to operate on that basis and put each individual laundry on its own funding. That is a problem we haven't got the answer to yet but we hope to get it.

Now in figuring out your cost for operating an industrial fund, you include personnel, raw materials, and overhead. You exclude plant and capital equipment. I feel--although some of my associates disagree violently--that the law should be amended to permit you to include as an operating expense the acquisition of new equipment and to charge off depreciation.

It would seem to me rather ridiculous for United States Steel to operate on some method by which somebody else determined its costs and provided the money to replace its capital equipment instead of the company having to operate in such a way that it would accumulate cash to replace that equipment.

However, we are not even a little bit optimistic about attaining that because that would take from the Congress one of most closely held privileges or responsibilities, that of appropriating specifically for what you are to buy.

Again, if you want to establish a certain industrial fund, you go through much the same process as you did in establishing your stock fund. The determination of suitability is not quite so easy. Items that are

suitable for an industrial fund are those that produce something or maintain something. In other words, they take in either raw materials or a broken down piece of equipment, put some services into it, increase its value, and then sell it.

There are some people who honestly and intelligently think that we can operate our depots on an industrial fund. We strongly disagree. That depot sells no product. All it does is receive, store, ship, and keep the books on military supplies. We do not think that a depot is a suitable activity to operate under an industrial fund.

To establish an industrial fund you determine your assets which are your inventory, your materials on hand, and your work in process. Your work in process is part of your assets because you have put something into it, you have increased its value. Therefore, you pick that up, charge off your liabilities, and your net--very simply--is your capital. You transfer that to your capital account; then you are again in business.

You must obtain cash because you must meet your payrolls. You must keep your raw materials flowing in prior to the time the cash starts to flow in from your customers. Again the Congress has appropriated a consumption budget to cover these activities. Your customers have cash; you have a going concern; you are turning out products; the customers are paying for them; and you are getting the money--we hope.

Now I would like at this point to indicate more or less the general basic differences, at least the ones you can see at a glance, between stock funds and industrial funds. A stock fund finances selected categories of items currently within depots in the continental United States. Shortly it will be overseas, everywhere in the world; wherever that category is in our bulk supply system, it is under a stock fund. An industrial fund finances operations at one point, a complete installation like the Rocky Mountain Arsenal or a division or an installation like the Manufacturing Division of the Philadelphia Quartermaster Depot. One other thing I should mention is that your stock fund buys from your industrial fund and sells to it.

In many cases your raw materials for a manufacturing operation and in all cases your spare parts for a maintenance operation are carried in the stock fund, sold by the stock fund to the industrial fund of that installation. After the item is ready to go in stock, enhanced in value, the industrial fund sells it back to the stock fund.

In summary, I would like to point out that there are many advantages to working capital funds; however, they are not a cure-all. They are not

a substitute for good sound judgment and knowledge nor for item and quantity control in our supply system. The present laws, rules, and traditions prevent a full realization of a commercial operation. They prevent a full realization of the benefits that might--and we hope ultimately will--accrue from the operations of working capital funds.

I want to re-emphasize, apply both of these funds only to things and activities to which they are suited and which they will improve. We are just learning to use them in the Army. Some of my Air Force associates tell me they are in somewhat the same situation. As a matter of fact, it was a top man in the Air Force who declined to speak here and suggested they get me instead. He said he was prejudiced.

In case there is any doubt about the magnitude of these funds, I think this will dispel it. I happened to notice the other day that one large company has total assets of 1.2 billion dollars in its division which manufactures lamps alone. The clothing and equipment segment of the Quartermaster Division of the Army stock fund--which is part of the total Department of Defense stock fund setup--has assets of 2.8 billion dollars. To me that is awesome. When you add up all the rest, you really have a big corporation.

I have addressed myself today, advisedly, primarily to the mechanics of operating working capital funds. I have, again advisedly, kept it on what I would call a working man's level. I hope that I haven't insulted the intelligence of my audience, but that is the only level I could put it on.

The greatest advantages, though, that will accrue from the operation of working capital funds will be the generation of complete, accurate, and timely data, and the intelligent and common-sense evaluation at all levels--again, let us remember that these data are most useful at the lowest level of management at which it can be applied--of management. I have in effect told you all I know about working capital funds.

I have with me this morning the men who attended the birth of the Quartermaster Division Army Stock Fund. They are available to you now during the discussion period, and they are available to all members of the Industrial College, not only now, but at any time they can be of any service. If we can help you in this field or in any other field in your studies, I would feel very badly if you did not make that known to us and give us the opportunity.

I thank you very much for your kind attention.

COLONEL GOLDSMITH: General Denniston is now ready for your questions.

GENERAL DENNISTON: I have seated down in front Mr. Brod, Deputy Comptroller, Quartermaster Corps; Colonel Gilly, Chief of the Budget and Fiscal Division; Colonel Dews and his assistant, Major Stutzman, who has had a lot to do with the establishment of stock funds in the Quartermaster Corps. So I think among us we are reasonably well equipped to answer your questions.

QUESTION: General Denniston, you stressed very strongly that the purpose of all this was to help the lower levels in their handling of stock funds. Could you go a little more deeply into that? I don't quite follow it.

GENERAL DENNISTON: Well, I think you could compare the dollar data generated in the operation of stock funds very much to the item and quantity data which we still have and which previously was the only data we generated in the operation of our stock control in our supply system.

Now, it seems to me that if, down at the lowest level, your operators and your customers are completely conscious of the price, if they know in dollars the values of their inventories, their balances, and they analyze the dollar data along with the item and quantity data, they should be able to perform their job better. One reason is, I think, they will be more conscious of the value. That is not a principal or the principal reason. I feel that they at the lower levels can utilize the dollar data as a warning signal. Again, if you are away over in a category in dollars, that will not tell you what is wrong itemwise or quantitywise in each item, but it will give you a red flag on the play sooner than your item and quantity data would. To me that is a big advantage. Stutz, would you like to add to that?

MAJOR STUTZMAN: Yes sir. We see that as a possibility of encouraging supply discipline. As the General mentioned, it is not the sole one, but to the extent that we can encourage the use of the dollar data all the way down through the lower levels, it will be an advantage.

QUESTION: I would like to go back to the mechanics of adopting the stock fund. You write down the assets; then you are stuck with all cash and inventory. I understood you to say you obtain obligated balances. How does Congress feel about this?

GENERAL DENNISTON: You were not stuck with any cash. You didn't have any cash. You were stuck with a lot of inventory. That is authorized

by the law and is reported to the Congress in connection with your defense of your budget. It is not an undercover deal, and I would say offhand that Congress probably likes it because then when you go up for your budget, you can state, "We would be asking you for so many million dollars of cash for purely financing purposes; instead during the prior fiscal year we were able to save; we didn't obligate all the money you gave us and we have used it for this purpose."

This is the point to mention something that I meant to but skipped, that is the matter of withdrawal credits. Once you have your inventory capitalized, you are stuck with it. The only way they come off the shelves under the law is for the customers to have appropriated cash to withdraw it. The only way you can budget it--and it is authorized--is that when you capitalize you can withhold certain of your inventories and put them on what we call a withdrawal credit, in which case your customers can get those in effect as a free issue.

QUESTION: General, does the Army anticipate having one stock fund for the Department of the Army or will it have a stock fund for each technical service?

GENERAL DENNISTON: The Army has and anticipates to continue having one stock fund for the Department of the Army which will then be broken down into the Quartermaster Division, Ordnance Division, Transportation Division, and so on--for whatever number of technical services there are. As I indicated, we will divide the technical services into segments. At least at our level, and I believe higher, the funds are kept separately, but they are completely interchangeable. The Department of the Army can move its stock fund money back and forth between the Ordnance and other technical services, which gives them a certain amount of flexibility.

We are in the process now of establishing stock funds in petroleum and its products and general supplies for which we need a rather small amount of cash capital. In the same process, we turned in to the Army stock fund many times that capital. So presumably some of the capital from one of our funds which was saved will come back to be used in one of the other segments.

COLONEL BARNES: I have a question but before I ask it I want to go back to a question previously raised. I can see a great advantage, as you pointed out, from a supply discipline standpoint and flexibility in having the stock fund operation, the pricing operation, get down to the lower management level, but does that mean that at every level of distribution from the depot on down, that the smallest post, camp, and station receiver get into the stock fund operation? I think that is

unnecessary. You could have all the stock fund advantages realized by having the consumer purchase in bulk from each Army area and then have the issue filter down to the ultimate receiver. I would like to get that point cleared up.

GENERAL DENNISTON: Let us go back and clear up the ultimate receiver. That does not mean the stocks are on hand in the 2nd Infantry at Fort Sam Houston, if that is where they happen to be. They are not. The bulk stocks on the post at Fort Sam Houston will be in the various segments, in our case with the Quartermaster Division, our stock fund.

COLONEL BARNES: Who will they buy from?

GENERAL DENNISTON: They will not buy from anybody. They will be part of one big stock fund. They will be included in the stock fund that heads up here.

COLONEL BARNES: Then they don't have to make a consumption budget report.

GENERAL DENNISTON: No. They don't consume anything. It is not consumed until the post, camp, or station supply officers issue it to a using activity.

COLONEL BARNES: I get it.

GENERAL DENNISTON: I believe that their accounting will be very simple and, of course, one big advantage there is that for the first time it will give us knowledge of our total inventory. Now the Navy has had that for a long time and I think the Air Force was born with it, but the Army has been criticised ever since World War II because so large a proportion of its inventories were not included in the assets, particularly when you want to budget.

COLONEL BARNES: I notice that you mentioned that one item which was excluded from the capitalization of the stock fund was your administrative cost. How was your overhead then budgeted for? Is that in the perform-budget?

GENERAL DENNISTON: Your overhead is budgeted entirely separate. It has no relation whatsoever to the stock fund, and that is one of the points at which we depart from good commercial practice and where in my opinion we lose some of the maximum value we might get from the operation of the stock fund.

QUESTION: It seems to me that this is a vehicle for budgeting. From what little experience I have had, at the lower level accounting a lot of our effort is devoted toward an accounting for property that is issued. I am sure that if the large industries had to put up with the reports of surveys because an account is not in condition to audit, they would soon be out of business. What is the plan for extending this cost accounting to accounting for the items, to inventory accounting, instead of just a budget institution, where we will account for the property on hand on a dollar value basis rather than on an item basis?

GENERAL DENNISTON: I don't know that we can ever get away from an item basis of accounting except possibly at the lowest level. Now what you are putting your finger on is what we do in the sales commissaries. We get a price on everything; if we are short on beans and long on coffee, but come out even on money, we are okay; we forget it, except on our requisition we have to balance with the customer demand. I don't know. Does anybody else want to discuss it? I don't know whether we can carry that throughout the works or not.

MAJOR STUTZMAN: That is something, of course, from a procedural and implementation point of view has given us quite a lot of trouble. That is the difference in the basic concept of the industrial approach as compared to the Government's. However, when we consider the international aspects of requirements and we consider throwing out the basis on which we get the basic material, namely, availability and turnover of the items, it immediately gets questionable whether or not this additional cost that we might do away with by losing stringent controls of property might possibly be a danger in that we had less accurate data pertaining to the basic items that we need international data on for requirements purposes.

GENERAL DENNISTON: You have given me the opportunity for one of my pet speeches, that is, the basic reason for keeping track of how many of each item you have--I don't care where it is--is so that you know what your assets are. By doing this you know to what degree you can support the mission--in our case, of the Army; in other cases, of the Navy, the Air Force, and the Marines.

Now, to me safeguarding the Government's property by item accounting is secondary. The main purpose of our accounting system is to know what we have, and, as Major Stutzman point out, we can't very well capitalize until somebody gives us a system whereby we can know what our assets are. Therefore, we must know enough in advance what our requirements are so that we can go through the long, drawn-out process

of translating requirements into shoes on the boys' feet and rifles on their shoulders. Now we can put up with quite a little expense if that is the only way to obtain that. If there is a substitute, it would surely be good. And when it comes to safeguarding the Government's property, that is a command matter; that is a matter of supply discipline, and there is no accounting system in the world that will take care of it for command.

QUESTION: General, I want to discuss a previous question a little more. First, I will say that I concur heartily in your last speech. I am not impatient of your very detailed item accounting, which I think is essential whether it costs 10 cents or 10 million dollars. I don't think you have convinced the post commanders, though, in this group that this stock fund will do them any good so far as applying it to their post operations. The reason for this is that they must have this item accounting system so, in addition, it imposes another accounting system on them from which they don't feel they get any return--primarily because they have no control really over what they spend their money for. They have a bunch of tables of allowances, and I have heard any number of post commanders say, "Give me the million of whatever repair and utilities (R&U) budget; let me spend it. I will run this post for you." But, no, if they save any money on coal, we just grab it back and say, "That's fine." You could say, "Okay, you have saved 100,000 dollars on your coal bill. We will let you paint the houses down there." So they feel they have no control over how this money is spent. They are not buying. They are told, "You do this; you do that." So they say, "To h--- with you."

GENERAL DENNISTON: You have brought up a point that I deliberately skirted over in my text. I felt that station funding was a little involved for the time I could afford to give it in the 50 minutes allowed.

Now, along with the extension of the stock fund to post, camp, and station level will have to go some type of station funding. What type we will end up with, I haven't any idea right now. We could go--ideally from the point you bring up and it is an awfully good one--ideally from the point of view of giving a post commander responsibility, give him the means to meet that responsibility, and hold him accountable for meeting it, and the most economically possible way would be to give him so much money to operate his station for everything; just put him in business, say, in the technical services, including engineers R&U and everything else would be in the position of having stuff available for him to purchase, goods, services, everything.

In my opinion that could be done very easily on engineers R&U because he has, if he is allowed to, a great deal of scope to exercise his own judgment. As you say, he can say, "The temperature in all quarters and

buildings will be so much," and save on his fuel bill. And with that money he can do some very necessary painting which will preserve the buildings and increase the value of the Government's investment, or as my friend Bob brought out, cut the grass once a week or once a month; or he can make you, as he has me, cut my own grass. When we translate that over into food and clothing--any supplies which must be maintained in bulk for him--available to him and a lot of other people, we run into difficulties.

In the first place, I don't believe we will--I don't know whether we can or not--let every post commander be the judge as to how many uniforms a year everybody must have; or be the judge as to how many times a day, a week, or a month the cook will serve steak, milk, and everything else. I can see the congressional mail going up from certain areas when some commander decided the boys can get along on a 50-cent ration.

So from that point of view, I am not sure we are ready or ever would be. From the supply point of view, if every post, camp, and station commander eliminated the tables of allowances, the things that guide him in how much of everything he can have, I am afraid we would be topside in an awful fix in trying to decide what the stock fund is used for.

I couldn't agree with you more heartily. We are far short of a real commercial operation which gives the plant manager the wherewithal and then holds him responsible to turn out the best product that will compete on the market at the lowest cost which will give us the greatest profit.

Now there is an awful lot to be solved. I think there is a lot that is just not solvable. That is what I meant in my words of caution. We can get great benefit from these things but let us not exaggerate, let us not expect things of them that they can't do. We can kid each other; we could kid the public; but let us not kid ourselves as to any of these new tools doing more for us than is inherently possible in them.

QUESTION: I would like to ask a followup question. You say, General, that you have an overall Army stock fund. Who manages that fund?

GENERAL DENNISTON: The Comptroller of the Army with the Assistant Chief of Staff G-4 financially manages it; policywise, the Assistant Chief of Staff G-4 has the responsibility.

QUESTION: Well, now, General, are the individual technical service stock funds part of this overall stock fund?

GENERAL DENNISTON: Yes, the Army stock fund is carried into a number of divisions. Now to a degree, except for the fact that the capital is flexible and can be moved back and forth, to reinforce one, to take something away here, in many ways, actually there is a stock fund for each technical service.

QUESTION: Well, then, the Quartermaster Corps operates its own stock fund separately from the overall stock fund?

GENERAL DENNISTON: That's right. We have the Quartermaster Division and each segment of it is capitalized separately. We have so many million dollars in the clothing and equipment stock fund; we have a considerable amount in millions in the subsistence--food--stock fund. We have considerably less in general supplies because the turnover value is less; the same in petroleum products.

QUESTION: Will all these vary from the overall stock fund?

GENERAL DENNISTON: We cannot, within an account, shift within the Quartermaster Corps from one capital to another without authority from above, but, if I need it and I can prove my point, I can get additional capital from the capital available in the Army stock fund to reinforce any one of my segments.

QUESTION: When you go to Congress to capitalize your stock funds, do you have a separate capitalization for the technical services and a separate one for the overall Army stock fund?

GENERAL DENNISTON: When we go to Congress--correct me if I am wrong--we go for capital if we need it. Of course, once these things get going, if you manage them right, you don't need more capital. It has been going the other way, as a matter of fact. But I believe the Army gets capital for the Army stock fund and they then distribute it to the divisions and segments as needed. Is that correct, Stutz?

MAJOR STUTZMAN: Yes, sir, by precedent. We are very new in that and, until the current year, in budgeting the Army stock fund, it has only been for the Quartermaster Division, plus the Defense supply service, the administrative division for acquiring office supplies for the Pentagon. But beginning in 1954 we will add subsistence and the Surgeon General will add medical and dental supplies. Previously these three divisions were treated separately by the Army Budget Review,

Defense Budget Review, Bureau of the Budget Review and each category operated a separate fund for cash operation, investment, turnover, and analyzed each one by segment of supply. So by precedent the Quartermaster now has four to individually defend even though they have not so segregated it.

GENERAL DENNISTON: So subsequent to 1 July the Quartermaster stock fund, Defense, and defense Supply Service--a little operation which takes care of the Pentagon--we had the works up until then and some of our segments were started then and on 1 January.

I might mention one more thing that I think is important and that I swept over, that is stock funds and industrial funds are not permitted to operate completely freely as a corporation would. A corporation takes in the money. It is the judge as to whether that money goes to the capital account, to increase its sinking fund, to buy equipment, to buy anything, to increase the payroll, or whatever it wants to do. On the other hand, as the cash flows from our customers into the stock fund capital, it is credited to our capital; it is ours except for one thing: To spend that, starting with the Bureau of the Budget, an apportionment has to come down the chain to us to authorize us to spend the money we have on hand. So, again, we have an artificial restriction on our ability to manage this fund as a corporation would.

COLONEL GOLDSMITH: General Denniston, I think you can see there has been an array of hands in the room which indicates to you the interest in the subject and attests to the very fine lecture you have given us. It is close home to many jobs a lot of us have had. Thank you for a fine presentation and for bringing your team with you and offering to us their services. It so happens that the students are writing papers in the area discussed and you may get calls yourself and also members of your team for help on this subject. I thank you and all of your team for your services.