



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

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JULY 25, 1983

The Honorable Mark O. Hatfield
Chairman, Committee on Appropriations
United States Senate

Dear Mr. Chairman:

Subject: Review of Air Force Accounting Practices
for Financing Depot Maintenance Contracts
Through Its Depot Maintenance Industrial Fund
(GAO/AFMD-83-86)

In Senate Report 97-580 on the fiscal 1983 Department of Defense Appropriation Bill, your Committee asked us to look into the merits of the Air Force's current practice of financing depot maintenance contracts through its depot maintenance industrial fund rather than through direct appropriation. The depot maintenance industrial fund--a working capital fund--uses customer orders for the repair of major end items of equipment to generate the budgetary resources (authority to incur obligations) needed to finance depot maintenance contracts.¹ The Committee asked us to determine whether depot maintenance contracts should be financed by direct appropriation and, if so, the earliest possible date for this transition. We discussed the request with your office and agreed that in evaluating "the merits of the Air Force's current practice," we would address our review toward determining whether the Air Force has effective controls to (1) ensure that obligations are not incurred for depot maintenance contracts in advance of appropriations and (2) if such controls are lacking, whether the contracts should be financed by direct appropriations.

The Committee's concern over this question was prompted by our earlier report entitled "The Air Force Has Incurred Numerous Over-obligations In Its Industrial Fund (AFMD-81-53, Aug. 14, 1981)." The report showed that the Air Force was illegally financing portions of depot maintenance contracts using obligation authority the industrial fund expected to receive from anticipated customer orders in the following fiscal year. This practice amounted to using appropriated funds before they were authorized by the Congress, which circumvented the appropriation and apportionment process and

¹See encl. I for description of industrial fund operations and financing.



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was not in accordance with the intent of the Congress or Office of Management and Budget guidelines.

In our report we recommended that if the Congress wanted the Air Force to continue to fund contracts covering more than one fiscal year through the industrial fund it should provide the budgetary resources necessary to finance them. Subsequently, the House and Senate Appropriations Committees in their fiscal 1982 conference report directed the Air Force to award only those contracts for which appropriations are available. Further, in the fiscal 1983 Defense Appropriation Bill the Congress provided funds to the Air Force to fund those contracts that had been financed through the industrial fund based on anticipated customer orders.

While disagreeing with our report that it acted illegally, the Air Force revised its procedures to require a fully funded customer order prior to the award of a depot maintenance contract that obligates industrial funds. As a result of these actions, the Air Force industrial fund no longer uses anticipated customer orders as obligation authority. The new procedure satisfies our objection to the practices discussed in the report and provides the needed administrative control over industrial fund financing of depot maintenance contracts. Therefore, on the issue of administrative controls to preclude overobligations, we see no reason to recommend discontinuance of the practice of financing depot maintenance contracts through the Air Force industrial fund.

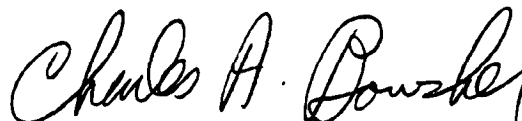
On June 16, 1983, we obtained Defense comments on a draft of this report. Defense officials told us that while they generally agreed with the report, they still objected to the conclusion in our earlier report that the Air Force practice was illegal. Their objections were the same as the ones we responded to in the August 1981 report. The issues and rationale for our reservations about the legality of the accounting practices are fully developed in that report. However, as indicated above, the practices giving rise to our reservations no longer exist.

While the Air Force's action satisfies both the Committee's and our concern that obligations should not exceed budgetary resources, still other industrial fund issues remain to be addressed. For example, there is a lack of consistency in the military services' policies regarding the amount of contracting that can be entered into by industrial fund activities pursuant to a customer order. Currently, the Air Force may enter into contracts for entire customer orders, the Navy may contract for up to 80 percent of the value of the order, while the Army generally is not allowed to contract for industrial fund orders. We are addressing this and other issues at the request of the House Appropriations Committee and will be reporting on them in the future.

Enclosure II provides the objectives, scope, and methodology used for our review.

As arranged with your office, we are sending copies of this report to the Director, Office of Management and Budget; the Chairman, House Appropriations Committee; the Chairmen, House and Senate Armed Services Committees; the Secretary of Defense; and the Secretary of the Air Force. Copies will also be made available to other interested parties who request them. Please let us know if we can be of further assistance.

Sincerely yours,

A handwritten signature in cursive script that reads "Charles A. Dowsley".

Comptroller General
of the United States

Enclosures

FINANCING INDUSTRIAL FUND OPERATIONS

Defense activities typically financed under industrial funds include shipyards, depot maintenance (repairs, modifications, and overhauls to major end items of equipment such as ships and aircraft), and airlift and sealift transportation service. The industrial funds are set up and managed by the military services (Army, Navy, and Air Force), and the Defense Department to service equipment and provide commercial type services to its military commands or activities. The depot maintenance activity, through receipt of customer orders from the military commands or activities, determines its total maintenance requirement and the amounts to be performed by in-house personnel and by contract. Generally, the in-house capability is utilized to the fullest extent possible. The remaining requirements are placed with commercial contractors through depot maintenance contracts.

Department of Defense industrial funds are operated as revolving funds. As such, they should be self-sustaining; that is, costs incurred in producing or contracting for goods and services ordered by customers of the fund are to be recovered from the ordering military service activities. To facilitate the financial operations of industrial funds, limited amounts of working capital, or fund corpus, have been provided through one-time appropriations by the Congress. However, most industrial fund budgetary resources (authority to incur obligations), are generated through the receipt of customer orders. Under this reimbursable process, customer activities use their appropriations to fund orders placed with the Defense industrial funds. When the military service customer submits the order, it records an obligation on its accounting records for the amount of the order. When the industrial fund activity receives and records the order, its own budgetary resources (obligational authority) are increased by the amount of the order. These industrial fund budgetary resources are then used to finance obligations incurred to fill the customer order.

OBJECTIVES, SCOPE, AND METHODOLOGY

The initial objective of our review was to assess the merits of the Air Force arguments as to the advantages of financing depot maintenance contracts through its industrial fund in lieu of direct appropriations. However, after discussing the request with the Committee's office, we agreed to address our review to evaluating recent procedures established by the Air Force in response to our prior recommendations to determine if they provided the needed administrative control over industrial fund financing of depot maintenance contracts. Our review was performed in accordance with generally accepted government auditing standards. We examined applicable Department of Defense and Air Force regulations, accounting and financial management reports, congressional hearings, and budget documents. We also discussed with Defense and military service officials the advantages and disadvantages of financing depot maintenance contracts both through the industrial fund and through direct appropriation.

Our review was conducted between January 1983 and May 1983 at the Department of Defense and at Headquarters, Departments of the Army, the Navy, and the Air Force, Washington, D.C.; the Air Force Logistics Command, Dayton, Ohio; and the San Antonio Air Logistics Center, San Antonio, Texas.