

REPORT BY THE

Comptroller General

OF THE UNITED STATES

Criteria For Recording Obligations For Defense Stock Fund Purchases Should Be Changed

This report presents GAO's evaluation of Department of Defense procedures for obligating Operation and Maintenance appropriations for stock fund purchases. The Office of the Secretary of Defense recently notified the military services of a pending change in policy regarding the point in time when obligations would be recorded for purchases from stock funds. Under the change, obligations would be recorded at the time orders are placed with the stock fund rather than at the time items are delivered.

GAO believes this change would improve administrative controls over appropriations and provide other benefits. Accordingly, GAO is recommending that the change be implemented by Defense as soon as practical.



GAO/AFMD-83-54
AUGUST 19, 1983

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

B-208863

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

The Honorable John G. Tower, Chairman
Committee on Armed Services
United States Senate

The Honorable Jamie L. Whitten, Chairman
Committee on Appropriations
House of Representatives

The Honorable Melvin Price, Chairman
Committee on Armed Services
House of Representatives

This letter presents our evaluation of Department of Defense procedures for obligating Operation and Maintenance appropriations for stock fund purchases. Our evaluation was made as part of an overall review to determine if obligations of Operation and Maintenance funds in Defense were being made in accord with existing statutory requirements. This report is being sent to you because Defense has asked for \$194.6 million in Operation and Maintenance funds to finance a change in the way obligations for purchases from stock funds are recorded. Details of our findings and recommendations are in appendix I.

Defense stock funds, which are operated under the working capital fund concept, finance the purchase of materials and common-use items and hold these items in inventory until purchased by customers. Generally, these customers are the military services or Defense agency operating units. In Defense, stock funds sometimes also act as procuring agents for items that are not normally handled by the stock fund. In both cases, customer activities use appropriated funds, primarily Operation and Maintenance, to reimburse the stock fund for the cost of items delivered. Proceeds from sales are then used by the stock fund to purchase additional items for future sales. Stock funds, as structured in Defense, are intended to provide better supply management, with single-manager, centralized procurement for designated items. In so doing, stock funds can provide the benefits of quantity buys, avoid duplication in purchases, and reduce overall inventories by combining the materials and supplies used by two or more services.

Since 1968, Defense regulations have generally required that obligations for purchases from stock funds be recorded at the time the material is dropped from stock fund inventory records for delivery to the customer. This policy can present a significant problem because the customer has little control over when funds are obligated. Not being able to record obligations until ordered items are delivered by the stock fund creates additional problems near fiscal yearend. For example, when high priority items are not, or may not be, available for prompt delivery, customers may have no choice but to instead order items that are less critical to their needs, but which can be delivered before available funds expire. We have long been of the view that the criteria Defense now uses should be changed so that obligations for stock fund purchases are recorded at the time orders are placed. If uniformly implemented throughout the Department, this change would improve administrative controls over appropriations by allowing Defense activities to better control when obligations occur.

In 1974, Defense attempted to change the criteria so that obligations for stock fund purchases would be recorded when orders were placed with the stock fund rather than at the time of delivery. Defense asked the Congress for an appropriation of \$155 million to finance the change in procedures. According to Defense, the additional obligational authority was needed to finance obligations for items that would be ordered from the stock fund but not delivered by the end of fiscal 1975. (Without the change in criteria, no fiscal 1975 funding would have been needed for these items since obligations would not be recorded until the following fiscal year, or later, when delivery was made.) The Congress denied the Defense request for funds and, in commenting on the denial, the Senate Appropriations Committee reported that "therefore, the change in accounting procedure will not be implemented...."

The Department of Defense interpreted this action as a mandate not to make the change in policy for recording obligations for purchases from stock funds. As a result, Defense has continued to require the military services to obligate appropriations for purchases from stock funds at the time of delivery. It is not clear whether Defense was correct in interpreting the wording in the 1974 Senate Appropriations Committee report as a mandate. Based on our own independent analysis of the legislative history behind the issue discussed in the 1974 Committee report, and our discussions with current Committee staff, we were unable to determine whether the Committee was specifically opposed to the accounting change or only against providing additional funding for making the change.

Although the Defense policy requires that obligations be recorded at the time of delivery of items by stock funds, the military services have independently and in differing ways changed their own procedures and now, in varying degrees, record obligations for stock fund purchases at the time orders are placed. (Since about 1977, the Army and Air Force have selectively recorded obligations for some stock fund purchases when orders are placed.

In 1981, the Navy changed its procedures and now records obligations for all stock fund purchases when the orders are placed.)

Using these procedures, the services, contrary to Defense regulations, recorded an estimated \$222 million in obligations against fiscal 1982 Operation and Maintenance appropriations for items that would not be delivered until after fiscal 1982. According to Defense officials, the services funded these obligations without specifically requesting any additional appropriations. Although Defense officials felt that the Defense policy was somewhat unclear, they agreed that these obligations should have been charged, under the present Defense policy, against the funds current at the time the stock fund items were delivered; that is, fiscal 1983 or later.

In November 1982, Defense again proposed a change in its policy so that obligations for stock fund purchases would be recorded when orders were placed with the stock fund rather than at the time of delivery. The Assistant Secretary of Defense (Comptroller) said that this proposed change would result in Defense procedures "being in conformance with...GAO requirements." Office of the Secretary of Defense officials informed us that as part of its fiscal 1984 budget request, Defense has asked for \$194.6 million in Operation and Maintenance funds to finance the change in stock fund obligation criteria it wants to make. They said that this amount would fully fund a one-time requirement in the Army and Air Force for completing the change. Because the Navy is already recording obligations for purchase of items from the stock fund when orders are placed, no additional funds are needed for the Navy to make this change.

During this review, in addition to discussions with Senate Appropriations Committee staff, we contacted staff members from the House Appropriations Committee and the House and Senate Armed Services Committees to discuss their views on this issue and the related Defense request for fiscal 1984 funds. Staff members from all four committees agreed that the change in procedure would improve overall financial management in the Department. However, they could not say if the funds requested to make the change would be approved. At the time of this report, the Defense request for fiscal 1984 Operation and Maintenance funds was still being considered by the Congress.¹

¹In its report on the fiscal 1984 Defense Authorization Act (Report No. 98-107) the House Armed Services Committee recognized "the importance of the benefits that may accrue to the Department of Defense as a result of the proposed change in procedures...." However, citing budget constraints, the Committee recommended that the \$194.6 million authorization be reduced. The other three committees that will consider the request had not yet acted at the time this report was being prepared.

We endorse the change in Defense criteria for recording obligations for stock fund purchases. We believe that this change would provide a consistent base from which the military services could operate and should improve overall financial management in Defense. In implementing the new policy, Defense should establish criteria so that obligations for the purchase of items that are normally handled by the stock fund are recorded when orders are placed. For items that are not normally handled by the stock fund, obligations should be recorded only upon formal acceptance of the order by the stock fund. Further, to the extent the stock fund has not awarded a contract for the non-stock-fund item by the end of the fiscal year, funds would have to be deobligated.

If all or part of the additional funds requested are not approved by the Congress, the Army and Air Force should seek ways to fund completion of the change in the same manner the two services have already funded a large portion of it. To ease any funding problem, full implementation of the new procedures could be phased in over a period of time. Because of current budget constraints, this could take more than one fiscal year to complete. We are also recommending that the Secretary of Defense, in adopting the new procedures, assure their consistent application by the military services, in accord with the criteria contained in this report.

The Department of Defense reviewed a draft of this report and generally agreed with our conclusions and recommendations. Defense also stated that the change would, to some degree, affect other appropriations that finance orders with stock funds and that even with the additional funding Defense requested, outlays would not be increased under the new procedures. Defense's comments are included as appendix II. Those comments and our evaluation are discussed in detail on page 8 of appendix I.

We are sending copies of this report to the Director of the Office of Management and Budget and to the Secretary of Defense.



Comptroller General
of the United States

FINDINGS AND RECOMMENDATIONS ON THE NEED
TO CHANGE DEFENSE DEPARTMENT CRITERIA
FOR RECORDING OBLIGATIONS
FOR STOCK FUND PURCHASES

Current Defense regulations generally require that funds be obligated for purchases from stock funds when items ordered are dropped from stock fund inventory records for delivery to the customer. A change to this criteria so that obligations would be recorded when the stock fund customer places the order would provide Defense activities with more effective administrative control over funds.

OBJECTIVES, SCOPE, AND METHODOLOGY

In order to evaluate the criteria Defense and the military services use to record obligations for purchases from stock funds, we interviewed cognizant Defense officials and reviewed legislative history, military service procedures, and Defense and military service regulations. We also obtained Defense estimates of pertinent fiscal 1982 Operation and Maintenance (O&M) obligations for purchases from stock funds but did not audit those estimates.

Our evaluation was made as part of an overall review to determine if Defense obligations of O&M funds were being made in accord with existing statutory requirements. Our review was made in accord with generally accepted government auditing standards.

WE STILL ADVOCATE CHANGE IN CRITERIA
FOR OBLIGATIONS FOR
DEFENSE STOCK FUND PURCHASES

Defense stock funds, which are operated under the working capital fund concept, finance the purchase of materials and common-use items and hold these items in inventory until purchased by customers. Generally, these customers are the services or Defense agency operating units. In Defense, stock funds sometimes also act as procuring agents for items that are not normally handled by the stock fund. In both cases, customer activities use appropriated funds, primarily Operation and Maintenance, to reimburse the stock fund for the cost of items delivered. Proceeds from sales are then used by the stock fund to purchase additional items for future sales. Stock funds, as structured in Defense, are intended to provide better supply management, with single-manager, centralized procurements for designated items. In so doing, stock funds can provide the benefits of quantity buys, avoid duplication in purchases, and reduce overall inventories by combining materials and supplies used by two or more services.

Since stock funds were first established in Defense, several different criteria have been used for recording obligations of customer funds for purchases from those funds. The primary difference

between these criteria has been the time when obligations were to be recorded. For example, prior to 1968, obligations were recorded when customers placed orders with stock funds. In 1968, Defense changed its policy and since then has required that obligations generally not be recorded until items are dropped from stock fund inventory records for delivery to the customer.

Since 1970, we have repeatedly endorsed a change to current Defense criteria so that obligations would be recorded when orders are submitted to the stock fund.¹

Current Defense procedures inhibit effective administrative control over funds

Current Defense regulations generally require that stock fund customers obligate their funds when items that are ordered are dropped from stock fund inventory records for delivery to them. For those items that are available for prompt delivery from Defense stock fund activities, this policy presents no major problems. This is because little time elapses between when the customer places a stock fund order and when that customer records an obligation of funds (that is, the time that items are dropped from stock fund inventory records).

Significant problems can arise with current Defense procedures, however, when items ordered from the stock fund are not available for prompt delivery. To the extent the stock fund must order the items from other sources, it cannot fully control or accurately predict delivery time. Thus, the customer who placed the order with the stock fund does not know when funds will be obligated. Not being able to directly control the timing of obligations greatly diminishes customers' capability to effectively control funds. This problem becomes more severe near the end of the fiscal year. To the extent high priority items are not, or may not be, available for prompt delivery, customers may have no choice but to instead order items that are less critical to their needs, but that can be delivered before available funds expire.

A related problem occurs when these items are ordered in one fiscal year but not delivered until the next. As noted above, most stock fund purchases are financed with O&M appropriations, which are available for 1 year. While stock fund purchases would normally be based, in part, on the amount of O&M funds available at

¹Under these criteria, customer activities would record obligations when orders are placed for items that are part of the stock fund system; that is, items with a stock fund number at the time orders are placed. When the stock fund acts as procuring agent for non-stock-fund items, obligations would be recorded when the stock fund formally accepts the order. (See p. 5.)

the time, delaying delivery until the following fiscal year precludes applying those funds to the purchase because the O&M appropriation would have expired. If new fiscal year O&M funds are not available to fund the purchase placed in the prior fiscal year, the stock fund, which paid for the item anticipating the customer's reimbursement, would have to keep the item unless it could find another customer.

The above problems were discussed in our March 4, 1970, report "Implementation of the Accounting System for Operations in the Department of Defense," B-159797; in our July 30, 1970, letter to the Director for Accounting Policy, Office of the Assistant Secretary of Defense (Comptroller); and in separate 1977 letters to the Chairmen of the House Committee on Government Operations and the Senate Committee on Governmental Affairs.

COMMITTEE STATES THAT THE CHANGE
IN OBLIGATION PROCEDURES WILL NOT BE MADE

Nine years ago, as part of its fiscal 1975 budget request, Defense asked the Congress for \$155 million to finance a change in the way the military services record obligations for stock fund purchases. The change, basically the same as what we have been advocating since 1970, would have required customers to record obligations for stock fund purchases when the orders were placed. This was in place of the process being used at that time where funds were obligated when the item was dropped from stock fund inventory records. According to Defense, the additional obligational authority was needed to finance obligations for items that would be ordered by the end of fiscal 1975 but not delivered by that time. (Without the procedural change, no fiscal 1975 funding would have been needed for these items since obligations would not be recorded until the following fiscal year or later, when delivery was made.)

The Congress denied the Defense request for an additional \$155 million "in the current environment of limited resource availability." In commenting on the Defense request, the Senate Appropriations Committee stated "therefore, the change in accounting procedure will not be implemented...." Defense interpreted this action as a mandate not to make the change in policy for recording obligations for purchases from stock funds. Accordingly, Defense has continued to require that the military services record obligations when ordered items are dropped from stock fund records.

It is not clear whether Defense was correct in interpreting the wording in the 1974 Senate Appropriations Committee report as a mandate. Based on our own independent analysis of the legislative history behind the issue discussed in the 1974 Committee report, and our discussions with current Committee staff, we were unable to determine whether the Committee was specifically opposed to the accounting change or only against providing additional funding for making the change.

MILITARY SERVICES ACTED CONTRARY TO INTENT
OF DEFENSE REGULATIONS

Each of the military services has, in varying degrees and manner, acted contrary to the intent of accounting requirements for stock fund obligations that are contained in Defense regulations. According to Defense officials, current Defense policy is intended to require that, generally, obligations for purchases of stock fund items be recorded only when items ordered are dropped from stock fund inventory records. Contrary to the policy, the military services are, in many instances, improperly recording obligations when orders are placed with the stock fund. In doing so, the services recorded about \$222 million more in fiscal 1982 O&M obligations than they should have.

Since 1968, the Defense Accounting Guidance Handbook, which specifies the accounting policies the services are to follow, has provided that obligations are generally to be recorded by stock fund customers when requisitioned items are delivered. By 1977, however, the Air Force and Army had implemented procedures that departed from this policy. The Air Force implemented exception procedures whereby its activities could obligate their funds once an order for items from the stock fund was submitted, even when no inventory of those items was maintained and the items would not be delivered during the current fiscal year. These procedures were further relaxed to include certain stock fund items normally maintained in inventory but temporarily out of stock. Using these procedures, the Air Force estimated that it recorded \$104 million in O&M obligations during fiscal 1982 for items ordered from, but not delivered by, stock funds.

Like the Air Force, the Army implemented procedures to allow activities to obligate funds once an order for items from the stock fund was submitted for which (1) no local inventory is maintained and (2) delivery will not be made during the current fiscal year. Using these procedures, the Army estimated that it recorded \$83 million in O&M obligations during fiscal 1982 for items ordered from, but not delivered by, stock funds.

The Navy has also abandoned the required accounting procedures. In March 1981, it requested permission from the Defense Comptroller to record obligations for stock fund purchases when orders were placed. In a June 2, 1981, letter, the Comptroller informed the Navy that he did "not believe it to be feasible to provide an exception to the drop from inventory rule for one service only." However, the letter also included guidance which appeared to conflict with this position by providing examples of situations where funds could be obligated based on placement of the order. The Navy interpreted the latter guidance as authority to change its procedures. Accordingly, the Navy implemented accounting procedures which required its activities to record obligations when orders were placed with the stock funds. Using these revised procedures, the Navy estimates that during fiscal 1982 it recorded O&M obligations of about \$35 million for items ordered from, but not delivered by, stock funds.

If Defense regulations covering O&M obligations had been followed, none of the Air Force's \$104 million, the Army's \$83 million, or the Navy's \$35 million would have been recorded.

DEFENSE SHOULD CHANGE PROCEDURES FOR RECORDING
OBLIGATIONS FOR STOCK FUND PURCHASES

On November 9, 1982, the Assistant Secretary of Defense (Comptroller) again advised the military services of a pending change in policy for recording stock fund requisitions. Under the new procedures, funds would be obligated "upon placement of an order with DOD Stock Funds." The Comptroller also stated that the change "will result in DOD practices being in conformance with...GAO requirements."

We believe that this change in policy should be implemented by Defense as soon as practical. However, to satisfy the requirements of 31 U.S.C. 1501, which provides requirements for recording obligations, Defense needs to distinguish between items that are part of the stock fund system and those that are not. Accordingly, Defense should establish the following criteria in implementing the new policy.

- Obligations for purchases of items that are part of the stock fund system (that is, items that have been assigned a stock number under regulations prescribed by the Secretary of Defense)² are to be recorded when orders are placed. Once obligated, these funds would remain available for expenditure until stock fund items are delivered, even though that may occur in a subsequent fiscal year.
- For items that are not part of the stock fund system (and therefore the stock fund is acting as a procuring agent), obligations are to be recorded once the stock fund presents formal notification to the customer that the order has been accepted. Further, to the extent the stock fund has not contracted for the items ordered by the end of the fiscal year, funds would have to be deobligated on customers' accounting records.

This change would provide improved administrative control over appropriations by enabling Defense activities to better control the timing of the obligation of funds for items purchased from the stock fund. In a May 17, 1983, memorandum for the Acting Deputy

²Stock fund numbers are assigned based on criteria established by the Secretary of Defense and the military services. The criteria are based primarily on the frequency of demand for the item. Stock fund numbers can be assigned on a Government-wide basis (national stock numbers) or by individual military services (local stock numbers).

Assistant Inspector General for GAO Report Analysis, the Under Secretary of Defense (Research and Engineering) stated that the change would also help to alleviate the risk of fraud, waste, and abuse that exists under current policy. It would do this by removing the pressures on customers and procurement systems to secure delivery of stock fund items before the end of the fiscal year so that obligations could be recorded, as discussed on page 2.

FISCAL 1984 DEFENSE BUDGET REQUEST
INCLUDES FUNDS TO IMPLEMENT CHANGE

Officials in the Office of the Secretary of Defense informed us that as part of the fiscal 1984 budget request, Defense has asked for \$194.6 million in O&M funds to finance the change in stock fund obligation criteria it wants to make. Officials said this amount represents an estimate of the amount of additional O&M obligations Defense anticipates the Army, Air Force, and Defense agencies would record in fiscal 1984 under the new procedures; that is, for stock fund items ordered but not delivered by the end of the fiscal year. Officials said that this amount would fully fund a one-time requirement needed to complete the change in the Army, Air Force, and Defense agencies. Because the Navy is already fully operating under a policy of obligating for purchase of items from the stock fund when orders are placed, it will need no additional funds to make the change.

Defense officials explained that in arriving at the amount to be requested, the military services were asked to provide estimates of amounts of fiscal 1984 funds each would need to implement the new procedures. The Army said it would need \$579 million (the Army estimate included other appropriations as well as O&M) and the Air Force said it would need \$215 million (all in O&M funds).

In analyzing the Army and Air Force estimates, Defense officials said they were able to identify amounts they felt should not be included in a request for new appropriations. For example, Defense officials said the Air Force estimate included a significant amount for petroleum products. Defense officials felt that because petroleum products are generally available upon demand, all fiscal 1984 requirements for petroleum products had already been budgeted for in the basic O&M request. This portion of the Air Force estimate, therefore, was deleted. The Army request was adjusted downward because Defense officials said it (1) included provisions for items for which it had already requested budget authority and (2) was based on overestimated requirements for stock fund items for fiscal 1984.

We did not analyze these estimates during our review. To verify the validity of the requirements for stock fund material that were used as a basis for the estimated need of \$194.6 million in fiscal 1984 O&M funds would entail considerable work and require a long time to complete--too long to be of any use during this session of Congress. Therefore, we do not know whether the amount requested is reasonable.

During our review, we contacted staff members of the House and Senate Appropriations Committees and the House and Senate Armed Services Committees to discuss both the change in procedures Defense proposed and the related request for fiscal 1984 O&M funds. These staff members generally agreed that the change in procedures Defense proposed would improve overall financial management in the Department. However, they could not say if the funds requested to make the change would be approved. At the time this report was being prepared, the Defense request for \$194.6 million in fiscal 1984 O&M funds was still being considered by the Congress.³

If all or part of the additional funds Defense requested are not approved by the Congress, the Army and Air Force should seek ways to fund completion of the change in the same manner the two services have already funded a large portion of it. To ease any funding problem, the remaining implementation of the new procedures could be phased in over a period of time. Because of current budget constraints, this could take more than one fiscal year to complete.

CONCLUSIONS

A change in criteria for recording obligations for stock fund purchases in Defense would enable activities to exercise better administrative control over appropriations. We believe the change in policy recently proposed by the Assistant Secretary of Defense (Comptroller) under which obligations for stock fund purchases will be recorded at the time orders are placed should be made as soon as possible and in accord with criteria detailed in this report.

RECOMMENDATIONS

We recommend that, apart from any action taken on Defense's request for O&M funds, the Army and Air Force complete, as soon as practical, the change in procedures for recording obligations for stock fund purchases that the Assistant Secretary of Defense (Comptroller) recently outlined to the military services.

We also recommend that the Secretary of Defense, in accord with the criteria detailed in this report, make sure the new procedures are uniformly implemented and effectively operated by all three military services.

³In its report on the fiscal 1984 Defense Authorization Act (Report No. 98-107) the House Armed Services Committee recognized "the importance of the benefits that may accrue to the Department of Defense as a result of the proposed change in procedures...." However, citing budget constraints, the Committee recommended that the \$194.6 million authorization be reduced. The other three committees that will consider the request had not acted at the time this report was being prepared.

AGENCY COMMENTS AND OUR EVALUATION

The Department of Defense reviewed a draft of this report and generally agreed with our conclusions and recommendations. In a June 6, 1983, letter, the Assistant Secretary of Defense (Comptroller) agreed that the change in procedure will improve administrative controls and that there is a need to ensure that the new procedures are fully implemented and operated consistently by all three military services. The Assistant Secretary added, however, that to effectively implement the change, Defense needed congressional approval of the funds requested. (See app. II.)

Regarding the military services' recording of \$222 million in improper fiscal 1982 O&M obligations for items ordered from the stock fund but not delivered by the end of the year, Defense officials agreed that these obligations should have been charged, under present Defense policy, against the funds current at the time the stock fund items were delivered; that is, fiscal 1983 or later. Those officials felt, however, that the current wording of Defense policy was not clear and was subject to different interpretations by the services. Defense added that the policy could be interpreted as allowing obligations, under certain circumstances, to be recorded when orders were placed. Because of this, Defense felt that the military services were not totally at fault in deviating from Defense policy. Defense also stated that the change would, to some degree, affect other appropriations that finance orders with stock funds, and that even with the additional funding Defense requested, outlays would not be increased under the new procedures.

Defense is correct in pointing out that the change would affect, although to a much lesser extent, appropriations other than O&M. We also agree that the change will have no impact on outlays, regardless of whether the Congress approves any additional funding. This is because the new procedures would only change the point in time that obligations are recorded; reimbursement would continue to be made after the items ordered are delivered. Regarding Defense's statement that the additional funding is needed to effectively implement the new procedures, we recognize that the change will result in the one-time recording of additional obligations. As pointed out in the report, however, we did not audit the amount of the request. Further, the Navy has already fully implemented, and the Army and Air Force partially implemented, the change in policy now being advocated without any specific Defense request to the Congress for additional funding. We believe that, if the Congress does not approve the additional funding requested, the Army and Air Force should seek ways to finance completion of the change in procedures in the same manner they have already funded a large portion of it. Under current budget constraints, this could take more than one fiscal year to complete.



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE

WASHINGTON, D.C. 20301

6 JUN 1983

Mr. W. D. Campbell
Acting Director
Accounting and Financial
Management Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Campbell:

This letter replies to your draft report, subject:
"Criteria for Recording Obligations for Defense Stock Fund
Purchases Should be Changed," dated April 14, 1983.

We hope that General Accounting Office support for our
proposed change in policy will be instrumental in achieving
congressional approval.

Two relevant points should be included in the body of the
discussion of the report. First, the proposed change in policy
will not increase outlays. It will require a one-time increase
in budget authority for the year in which the change is
implemented. Second, the proposed change will affect to some
degree all Defense appropriations that order supplies from a
stock fund; not only Operations and Maintenance appropriations.

In addition, we question the conclusion in the report that
the Services acted "wrongly" in recording \$222 million of 1982
obligations in conflict with Defense regulations. A review of
the language used to implement the policy supports in varying
degrees the interpretations to the policy implemented by the
Services.

Our detailed comments are attached.

Sincerely,

VINCENT PURITANO
ASSISTANT SECRETARY OF DEFENSE
(COMPTROLLER)

Enclosure

Finding A: GAO Has Advocated Changing the Criteria For Obligating Stock Fund Purchases Since 1970.

GAO states that it has endorsed a change in the current criteria for recording obligations of customer funds for purchases from stock funds since 1970. GAO's proposed change would require that obligations be recorded when requisitions are submitted to the stock fund; that is, customer activities would record obligations for items that are part of the stock fund system at the time orders are placed. Current DoD regulations require that funds be obligated for purchases from stock funds when items are dropped from stock fund inventory records for delivery to the customer.

Concur. However, this finding should be qualified. Current DoD regulations "generally" require that funds be obligated for purchases from stock funds when items are dropped from stock fund inventory records for delivery to the customer. For example, orders from stock of other than a local stock fund may be obligated when placed. (Para. 22106E2 of DoD 7220.9-H.)

Finding B: Significant Administrative Problems Arise From Current DoD Procedures.

GAO found that the current regulations present no problem when items are available for prompt delivery from Defense stock fund activities. Significant problems arise, however, when items ordered from the stock fund are not available for prompt delivery. One problem occurs when the stock fund orders the items from other sources and cannot predict delivery time. The customer who placed the order with the stock fund does not know when the funds will be obligated; thus, the budget holder's capability to effectively control funds is greatly diminished. A related problem occurs when items are ordered in one fiscal year but not delivered until the following year. Since most stock fund purchases are financed with O&M appropriations (one year) delaying delivery until the following fiscal year precludes use of those funds to pay for the purchase because the O&M appropriation would have expired.

Concur.

Finding C: The Military Services Are Disregarding Current DoD Regulations.

GAO states that in 1975 DoD had asked the Congress for \$155 million to finance a change in the way the Military Services record obligations for stock fund purchases. The request for funds was denied and the Senate Appropriations Committee stated "the change in accounting procedure will not

be implemented." GAO found that since then each of the Military Services has in some way disregarded the accounting requirements for stock fund obligations. During fiscal year 1982, GAO found that the Air Force recorded \$104 million, the Army \$83 million, and the Navy \$35 million using procedures contrary to DoD regulations. GAO notes, however, that recently (November 9, 1982) DoD again decided to try to change its required procedures for recording obligations under which funds would be obligated upon placement of an order with DoD stock funds. In addition, as part of the fiscal 1984 budget request, DoD has asked for \$194.6 million in O&M funds to finance the change in stock fund obligation criteria.

Partially Concur. Each of the Services has taken action contrary to the intent of the DoD policy based upon interpretations of guidance. For example, the Army has used para. 22106E2, cited above, as authority for recording \$83 million in stock fund "bypass" obligations. The Navy interpreted the response to its request for relief from the general policy as authority to obligate all orders placed with a stock fund because the response did not indicate that until the Congress permits the necessary budgetary actions, implementation of the authority to obligate orders as accepted when the local stock fund acts as a procuring agent is postponed. The Air Force interpreted the preceding condition as having been met as a result of approval of the budget by the Congress. We would fully concur with a finding that the Services modified the intent of DoD policy based upon interpretations of the written policy.

Conclusion 1: A Change in Criteria Would Provide Better Administrative Controls Over Appropriations if Properly Implemented.

In connection with Findings A and B, GAO concludes that DoD activities would be able to exercise better administrative control over appropriations if the criteria changes for recording obligations for stock fund purchases were made. If a change is approved by the Congress, there is the need to ensure that the new procedures are fully implemented and operated consistently by all three Services.

Concur.

Conclusion 2: The Services Acted Wrongly By Not Following Current DoD Regulations.

In connection with Finding C, GAO concludes that the Military Services acted wrongly in recording fiscal 1982 obligations of \$222 million by using procedures that conflict with current Defense regulations.

Partially Concur. See comments on Finding C. We would fully concur with a conclusion that the Services took actions contrary to the intent of the DoD policy based upon their interpretations of the guidance.

Conclusion 3: A Change in Procedures Should Be Approved By The Congress.

In connection with Finding C, GAO concludes that the Congress should approve the change in procedures apart from any action taken on the Defense fund request.

Partially Concur. We concur that the Congress should approve the change in procedures. However, we need congressional approval of the funds requested to effectively implement the policy change.

GAO Comment: In a draft of this report, we proposed that, apart from any action taken on Defense's request for O&M funds, the Congress approve the change in accounting procedure. Based on additional legislative research and subsequent discussions with staffs of the four committees to which this report is being sent, it became evident that congressional approval is not needed for Defense to make the change. Accordingly, our proposal has been changed to a recommendation that Defense implement the accounting change as soon as practical, which, depending on the availability of funds, may require more than one fiscal year.

Recommendation 1: GAO recommends that, apart from any action taken on Defense's request for O&M funds, the Congress approve the change in procedures for recording obligations for stock fund purchases that the Assistant Secretary of Defense recently outlined to the Military Services.

Partially Concur. We concur that the Congress should approve the change in procedures. However, we need congressional approval of the funds requested to effectively implement the policy change.

Recommendation 2: GAO recommends that the Secretary of Defense, in accord with the criteria detailed in this report, make sure the new procedures are fully and uniformly implemented and effectively operated by all three Military Services.

Concur. We concur with the need to fully and uniformly implement these procedures. However, we need congressional approval of the funds requested to effectively implement the policy change.

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