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DOD's Management of the Asset Capitalization Program Needs Improvement

Statement of
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Before the
Subcommittee on Readiness, Sustainability, and
Support,
Committee on Armed Services
United States Senate

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Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the results of our review of the Department of Defense's (DOD) management of its Asset Capitalization Program (ACP). The Congress approved this program in 1982 to bring about more business-like operations at industrial fund activities, such as aircraft maintenance depots, shipyards, and public work centers, that perform functions of an industrial or commercial nature. The program is intended to increase economy, efficiency, and productivity, and strengthen the industrial base by modernizing or rehabilitating existing plant and industrial equipment.

Under the program, the activities purchase equipment with industrial funds rather than direct appropriations. An activity initially finances the cost of the equipment and then charges its customers, such as fleet commanders and weapon systems managers, for work performed. The activity then recovers the cost of equipment by including the depreciation expense in charges to its customers. Between fiscal years 1983 and 1989, about $5 billion was approved for the program and about 80 activities were authorized to participate.

RESULTS IN BRIEF

The program offers great potential as a technique for financing projects needed to modernize industrial fund activities'

operations. However, while some ACP projects have achieved benefits, many others have not because of several management weaknesses that require corrective action.

First, the Office of the Secretary of Defense (OSD) has provided either limited guidance or unclear and conflicting guidance on what can be purchased with program funds. As a result, activities have used program funds on a wide-range of projects including some that appear to be inconsistent with the program's original intent. Second, when OSD or service and command guidance was specific, it was sometimes not followed. Third, the services have not yet adequately implemented the elements of a sound capital investment management program, including providing adequate management support; well-defined program criteria for justifying, reviewing, and approving projects; and post-investment analyses. Fourth, the services lacked or failed to follow internal control procedures designed to accurately account for and safeguard capital equipment.

Three other factors appear to have affected the program's execution. First, the increasing value of nondiscretionary purchases, which we define as service- or command-directed projects, for such items as management information systems, coupled with funding reductions, have restricted the activities' ability to buy needed plant equipment in recent years. Second the activities must obligate program funds by the end of the budget execution year or they lose them. To avoid losing money, some

activities bought lower priority items because they were readily available from commercial sources. Third, the current means of reporting program purchases, especially non-discretionary purchases, to the Congress does not provide sufficient visibility over the use of program funds.

BACKGROUND

Industrial fund activities, established by DOD with congressional approval in 1949, use working capital funds rather than direct appropriations to finance the cost of goods and services provided to customers.[1] The customers use appropriated funds to reimburse these activities for work performed. Industrial fund activities are industrial-type activities, such as Army and Air Force maintenance depots and Navy shipyards, and commercial-type activities, such as Navy public works centers and Air Force laundry and dry cleaning services. During fiscal year 1988, DOD operated 81 industrial fund activities (49 industrial-type and 32 commercial-type) that employed about 277,000 civilian personnel and did about $24.3 billion worth of business.

Prior to fiscal year 1983, DOD's industrial fund activities had to compete against the procurement of ships, aircraft, and weapon systems when requesting procurement funds for new plant equipment.

[1]DOD customers of the industrial fund include fleet commanders, weapon systems managers, DOD agencies, and other elements of DOD involved in logistics support.

According to DOD, the activities were generally less than successful in the competition and, as a result, many equipment requirements went unfunded. Over time, much of the equipment at these activities became outdated, inefficient, and less productive than similar equipment in the private sector. To correct this problem and allow for more business-like operations, DOD established the ACP in fiscal year 1983. The program's objectives are to increase economy, efficiency, and productivity and strengthen the industrial base by modernizing and improving industrial fund operations.

The ACP finances plant equipment acquisitions, modifications, and rehabilitations with a useful life of 2 years or more and costing more than $5,000.[2] It also finances minor construction projects costing between $5,000 and $200,000 with a useful life of at least 2 years and the development of management information projects costing more than $100,000.

Under the ACP, the cost of modernizing is shifted to the appropriations of each activity's customers. The cost of capital improvements becomes a part of each activity's operating cost and is recovered from its customers through depreciation charges over the useful life of the asset. For example, depreciation for

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[2]Prior to fiscal year 1986, equipment costing more than $1,000 was considered a capital asset and could be purchased with ACP funds.

equipment purchased by a Navy shipyard to repair submarines would be added to the costs charged for submarine repair work only.

OSD GUIDANCE DOES NOT ADDRESS PROGRAM PLAN

When OSD initiated the ACP it planned for industrial fund activities to primarily use the ACP funds to purchase plant equipment that contributes most to the accomplishment of the activities' missions. OSD stressed this fact in 1982 testimony before the Congress leading to the establishment of the ACP. The testimony contained several policy statements that, among other things, (1) called for the use of ACP funds rather than appropriated funds to satisfy most capital investment needs, (2) identified Defense organizations and equipment items for which ACP funds could or could not be used, (3) discussed procedures to be used in accounting for and depreciating ACP projects, and (4) established documentation requirements for ACP purchases and

follow-up analyses.[3] However, OSD guidance does not specify the program's intent to purchase primarily essential equipment, nor does it define essential equipment.

According to an OSD official who played a leading role in the program since its inception, when OSD formulated the program it intended for the activities to use the majority of their ACP funds to buy equipment that directly supported the activities' primary missions. He noted that in the case of DOD industrial (repair or manufacturing) activities, such as the Naval shipyards and Army arsenals, the activities should have purchased plant equipment that directly supported the operation of their repair or manufacturing shops. For these activities such equipment consists of industrial plant equipment (machine tools) and certain types of other plant equipment, such as materials handling equipment.

Our review of the hearing leading to the congressional approval of the program and subsequent congressional reports on the program corroborates the OSD official's views. For example, the fiscal year 1983 House Appropriations Committee Report on the Defense Budget focused extensively on industrial plant equipment for industrial activities. The fiscal year 1984 House Appropriations

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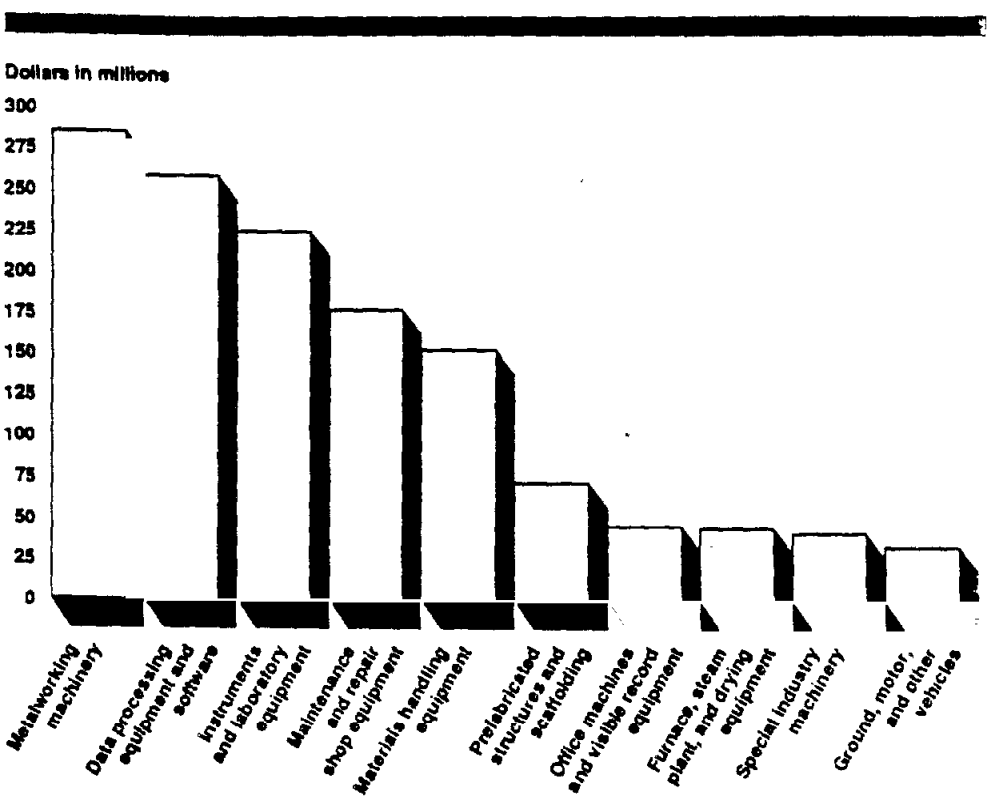
[3]Several ACP policy statements contained in a January 14, 1982, memorandum to the Service Secretaries were addressed in the testimony. Subsequently these policy statements were incorporated into DOD Instructions 7410.4 R "Industrial Fund Operations," dated April 1982 and 7410.4 "Industrial Fund Policy," dated July 1988. The services have issued various instructions to implement the DOD instructions.

Committee Report on the Defense Budget again only referred to industrial plant equipment purchased when it discussed the ACP program.

Our work focused on four commands and seven subordinate industrial fund activities. The activities used ACP funds to buy a wide range of equipment. Figure 1 shows the top 10 categories of equipment purchased between fiscal years 1983 and 1987 with ACP funds at the four commands we visited.

Figure 1: Top 10 Federal Supply Groups of ACP Purchases (Fiscal Years 1983-1987)



Although it appears that the need for most of the equipment purchases we reviewed existed, it is uncertain to what extent the purchases contribute to repair or manufacturing operations. For example, the top 10 equipment categories contained some equipment (automated data processing equipment and software development, prefabricated structures, office machines, and vehicles) that is not generally directly used in the repair or manufacture of items. The automated data processing category includes some computer attachments for industrial machines, but it also includes personal computers that do not directly contribute to repair or manufacturing operations. The office machine category includes such equipment as copying machines and word processors that do not directly contribute to these operations. Also, some vehicles should not have been procured with ACP funds. Furthermore, there has been significant growth in the four equipment categories. Figures 2 and 3 show the increased ACP purchases from fiscal years 1983 to 1987 in the automated data processing equipment and software and vehicle categories.

Figure 2: ACP Automated Data Processing Equipment and Software Purchases at the Four Commands Reviewed (Fiscal Years 1983 to 1987)

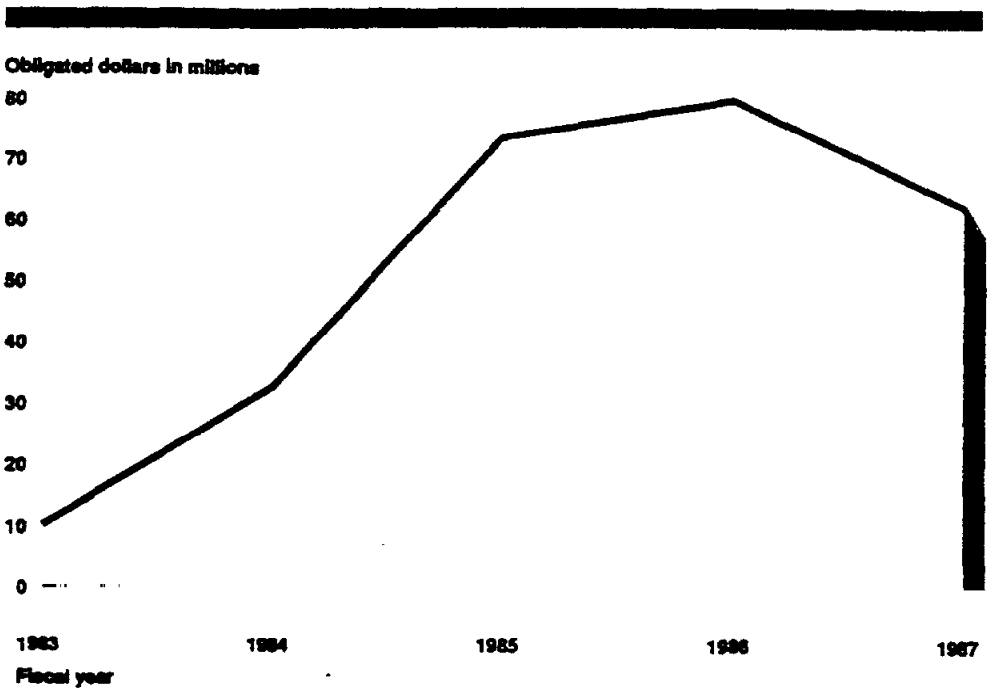
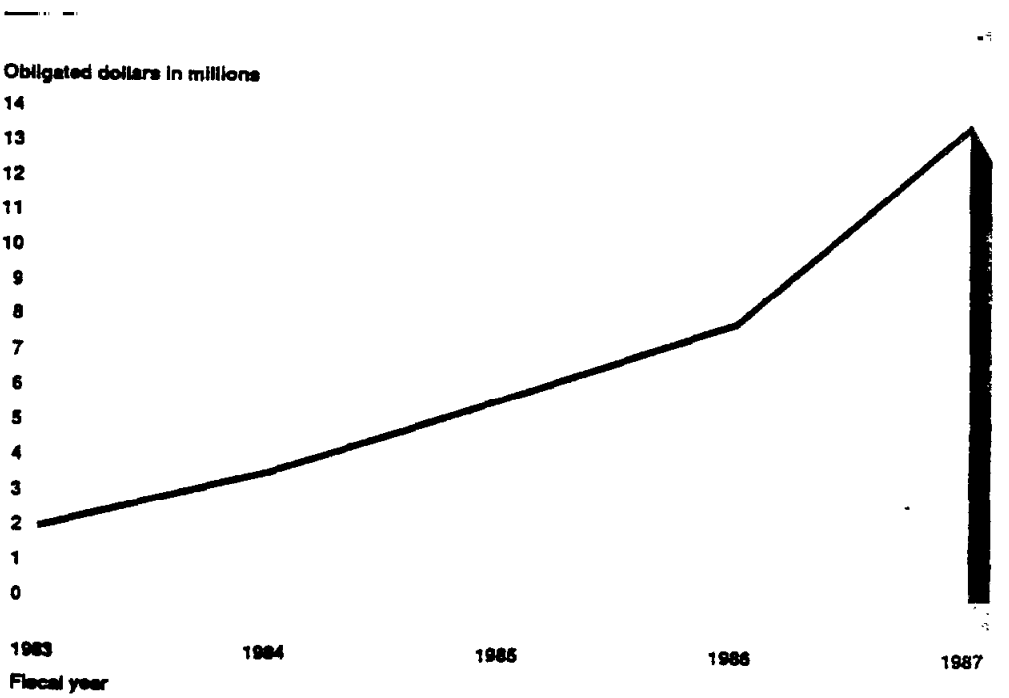


Figure 3: ACP Vehicle Purchases at the Four Commands Reviewed (Fiscal Years 1983 to 1987)



In addition we found examples of purchases in other equipment categories where the extent of their contribution to the fulfillment of the activities' missions was unclear.

-- The Yorktown Weapons Station purchased an insect sprayer for $5,300 in 1984. It used the sprayer about 5 times in fiscal year 1987 and, as of August 1988, it had not used the sprayer at all during fiscal year 1988. An official who supervises sprayer operations said that the primary locations sprayed are the family housing and golf course areas that do not provide direct support to the activity's primary mission.

-- The Watervliet Army Arsenal purchased over $500,000 of office furniture for numerous administrative and overhead organizations.

-- The Red River Army Depot purchased two automated drug detection systems in 1986 capable of testing 270,000 urine samples per year, for about $46,000 to perform drug tests of personnel in specifically designated critical positions. After procuring the systems, the depot determined that only 180 military and civilian personnel required an annual drug test, and only three of these personnel were associated with maintenance, the depot's primary mission. The depot determined that one system would more than satisfy its drug testing needs and, therefore, declared the other system excess.

DOD agrees that there is a lack of specific guidance to the services emphasizing the need to buy equipment used in direct support of the activities' primary mission and plans to provide such guidance to the services by September 1989.

OSD AND COMMAND ACP GUIDANCE NOT FOLLOWED

We also found instances when OSD or command guidance was specific regarding items that cannot be purchased with ACP funds and charging customers for unique purchases, but was not followed.

-- OSD guidance states that ACP funds used to purchase equipment unique to a particular customer or program should only be charged to that customer or program. Six Navy shipyards spent $81 million of ACP funds between fiscal years 1984 and 1988 on unique environmental enclosures needed for a special hull treatment on attack submarines. An additional $7.7 million is budgeted to acquire more enclosures through fiscal year 1992. Because of the uniqueness of the equipment and the amount of money involved, shipyard representatives recommended to the Naval Sea Systems Command, as far back as 1984, that only the specific customer should pay for the enclosures. These costs were charged to all customers rather than just the specific program sponsor.

-- Although OSD guidance precludes using ACP funds to purchase items for tenant activities, the Mare Island Shipyard bought 24 vehicles valued at $150,000 with ACP funds for its tenant activities. Shipyard officials knew this was an improper ACP expenditure, but stated that Mare Island had to provide vehicles for all shipyard activities and the ACP was the only available funding source. This use of ACP funds deprived the shipyard of funds that could have been used to reduce its backlog of industrial plant equipment projects.

-- Although an Air Force Logistics Command regulation specifies that the ACP is not to fund prototypes for new repair technology, we found that the Sacramento Air Logistics Center used about $3.2 million in ACP funds to cover a funding shortfall in DOD's Productivity, Reliability, Availability, and Maintainability program to procure a prototype stationary radiography system.

According to Center officials, no funding alternatives existed when the program's shortfall occurred: therefore, the Center decided to use ACP funds. Center officials believed the project would have been in serious jeopardy if they had not used ACP funds, risking the $7.4 million in program funds already expended.

ACP IS NOT YET A SOUND CAPITAL INVESTMENT MANAGEMENT PROGRAM

A sound capital investment management program includes (1) top management involvement and support, (2) a systematic approach for identifying investment opportunities, (3) well-defined procedures for justifying, reviewing, and approving projects, (4) prompt implementation of approved items, and (5) post-investment analyses to determine if anticipated benefits are being realized. We found deficiencies in each of these program elements.

Inadequate Management Involvement and Support

Top management involvement and support is one of the prerequisites for a successful capital investment strategy. Such involvement and support is demonstrated through clear program guidance, well-defined organizational responsibilities, and sufficient staffing resources for program management. Management involvement and support could be improved at all levels; OSD, service headquarters, commands, and the activities themselves.

OSD and the services have developed limited or unclear guidance on how the ACP should be managed. Some commands and activities are still operating under draft guidance and instructions. Other commands developed guidance that was not approved until several

years after the program began. For example, naval ordnance and weapon stations are still operating under draft guidance from its parent Naval Sea Systems Command. The Command, however, has implemented formal guidance for its shipyard activities, although the guidance was not approved until May 1987, 4-1/2 years after the ACP began.

According to an OSD official who has been associated with the ACP since its inception, one factor contributing to inadequate program guidance has been unclear organizational responsibilities. The official stated that a typical DOD program is run by a functional manager at the OSD level who provides overall program guidance, direction, and oversight which logically would be placed under the Assistant Secretary of Defense (Acquisition and Logistics). Currently, OSD has no functional manager for the ACP. Instead, OSD (Comptroller) staff handle program management responsibilities and view their role as a financial advisor to functional program managers. The OSD staff has generally only provided budget and accounting guidance for the program and collected and reviewed ACP financial data.

The OSD official also stated that OSD staff could not provide effective program oversight because of the limited data on the ACP program currently available at the OSD level. For example, OSD does not collect information on (1) the type and quantity of

equipment purchased under the ACP and (2) how many equipment buys are service- or command-directed versus activity-directed.

The activities also have unclear organizational responsibilities. No central ACP office or coordinator was responsible for managing and overseeing all equipment, minor construction, and management information system development projects. The ACP coordinators were generally concerned with equipment only. For example, the Norfolk Naval Shipyard program coordinator was only responsible for managing nonautomated data processing equipment. However, the individual's responsibilities included ensuring that budgetary limits were not exceeded on all ACP purchases. According to the coordinator, he could not execute his responsibilities since he had no control over funds spent for data processing equipment.

Although the ACP has increased the level of funding for equipment, the personnel assigned responsibility at each command for executing the program was not commensurate with those funding levels. The Naval Sea Systems Command, Ordnance and Ships, and Air Force Logistics Command ACP coordinators had many other collateral duties. As a result, the ACP had not received adequate attention. For example, the Naval Sea Systems Command's ACP coordinator had other responsibilities corollary to the ACP responsibilities. The coordinator was the only staff responsible for monitoring the activities program execution, yet the coordinator did not visit the activities to determine how the program was progressing or

whether funds were being spent in the most efficient manner. The coordinator did not make the visits because of other responsibilities and limited travel funds. In February 1989, we were informed that the Command had assigned a full time coordinator to the program.

Lack of a Systematic Approach To Identifying Investment Opportunities

The process of identifying investment opportunities is one of the most important aspects of a successful capital investment management program. A systematic approach to search for and identify investment opportunities can go beyond the routine replacement of worn-out equipment and result in the redesign of an entire work process. Comprehensive planning can identify ways that capital improvements can eliminate current bottlenecks in workflow and achieve significant gains in productivity and turnaround times. However, such planning was not occurring. For example, according to a February 1988 Logistics Management Institute report,[4] the services' maintenance depots did not evaluate projects by considering their interactions with one another and simply replaced old equipment with new equipment of the same type. The report concluded that:

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[4]David Glass and Lawrence Schwartz, Depot Maintenance Modernization, Logistics Management Institute (Bethesda, Md.: Feb. 1988).

> "The depots do not have a technological direction for modernization and, therefore, their capital-investment decisions are made on a case-by-case basis. As a result, opportunities for major improvements may be missed."

Furthermore, the activities did not always purchase equipment consistent with the needs identified in their long-range strategic plans. We found that 12 of 28 ACP projects were not in the activities strategic plans. Only 3 of 10 ACP projects (30 percent) were in the Sacramento Air Logistics Center's fiscal year 1986 strategic plan, and 9 of 18 (50 percent) ACP projects were in the Yorktown Weapons Station's fiscal year 1986 strategic plan.

Other audit organizations reported similar findings. For example:

-- Preliminary Army Audit Agency findings of capital equipment purchases at four Army depots showed that of 388 ACP projects funded for fiscal years 1987 and 1988, which were valued at about $43 million, 200 (52 percent) were not in the activities' strategic plans. At one depot, the agency found that only one of 46 projects were in the plan.

Procedures To Justify, Review, and Approve Projects Not Always Followed

A good investment strategy includes standard procedures for justifying, reviewing, and approving proposed investments. This strategy helps to ensure that capital resources are used on those projects with the greatest potential benefits. The OSD memorandum to the services requires that project justifications be adequately documented and include justification and economic analyses to ensure that a post-investment analysis and audit can be performed. According to OSD guidance, care should be taken to ensure that equipment that is bought for economic reasons should provide the greatest return on investment through increased productivity and reduced costs, and activities should be prepared to provide evidence of both proposed and actual benefits. For equipment that is purchased for noneconomic reasons, adequate justifications need to be prepared. Our work and recent Army Audit Agency, Air Force Audit Agency, and Naval Audit Service reviews found that compliance with existing procedures needs to be improved.

For example, for 106 projects we reviewed valued at about $83 million, there was no evidence that 11 projects had ever been justified. For the remaining 95 projects, 39 justifications, or 41 percent, were inadequate for such reasons as use of incorrect work load projections and equipment costs and inadequate

alternatives to purchasing equipment. The following illustrates some of the problems we and others found.

-- The Yorktown Naval Weapons Station did not consider the alternative of refurbishing existing equipment before buying a new crane valued at about $197,000. Yorktown officials said that it would have cost about $30,000 to refurbish the old crane. Yorktown officials commented that current Navy criteria allows for the replacement of the crane after 10 years. Therefore, they did not consider any alternative other than buying new components.

-- According to preliminary Army Audit Agency findings, Army depots did not prepare economic analyses for 289 of 411 equipment projects reviewed for fiscal years 1986 to 1989 valued at $43 million. The depots exempted the 289 projects from economic analysis because the Depot System Command had issued guidance that conflicted with Army regulations requiring such analyses. When the analyses were prepared, the depots seldom addressed alternatives to purchasing new equipment. The Audit Agency concluded that, as a result, the depots incurred unnecessary costs buying equipment rather than repairing or rehabilitating existing equipment.

In the area of command level review of projects, we found that commands and activities routinely approved projects without

adequately reviewing the projects' justifications. At 3 commands, we reviewed 31 project justifications that met the criteria for command review. The command reviews were limited and projects were approved on a perfunctory basis. Proposals were rarely disapproved or challenged, even when justifications contained incorrect economic analyses. For example, based on our review of eight shipyard projects valued at about $2.5 million that required workload verification, we found that the Naval Sea Systems Command did not verify whether the justifications contained current work load data for four of the eight projects valued at about $1.4 million. The Command is now requiring shipyard comptrollers to certify the accuracy of project justifications and plans to periodically visit the shipyards to review the comptrollers' work.

Implementation of Approved Projects

To obtain benefits as early as possible, the activities need to have well planned and timely project implementation. However, we found significant time lapses between the time equipment for a project was received and when it was either installed or became operational. We examined 106 ACP projects--some of which contained several pieces of equipment--valued at $43.3 million to determine their implementation status. Of these projects, 10 should have been operational, but were not. An additional two projects were not fully operational. For example, the Norfolk Naval Shipyard received a plate roll machine valued at about $273,000 in June

1987. It did not install the machine until April 1988, and had not started operating it as of September 1988. According to Norfolk officials, the reasons for the delay were (1) a lack of a proper oil to operate the machine, (2) electrical code violations that needed to be corrected, and (3) a lack of adequately trained machine operators.

In addition, the activities had received other equipment for ACP projects that should also have been installed, but was not due to various problems. For example, the Ogden Air Logistics Center received a $300,000 chromatograph mass spectrometer in July 1987 to measure the contents of aged propellant fuel. The Center stored the spectrometer in an empty building that was to be remodeled to house the equipment. At the time of our visit--about 13 months after the item was received--the building had not been remodeled and the spectrometer had not been installed or utilized. The manufacturer's warranty had expired.

Program Benefits Are Generally Not Measured

An effective capital investment program contains a mechanism for analyzing the success or failure of investment projects and for collecting data so that management can make better investment decisions in the future. OSD has not issued a formal requirement for the services to perform post-investment analyses. OSD guidance

only states that records must be maintained so that a post-investment analysis can be performed.

We found that Navy activities had not performed any post-investment analyses because they were not required. Air Force activities had not performed any prior to 1987 because they viewed them as manpower intensive and of questionable benefit. Army activities had performed post-investment analyses that showed many project benefits were overstated primarily because of optimistic work load projections. As a result, neither OSD nor the services know in total what benefits the ACP has produced.

We reviewed 82 projects valued at about $40 million at the seven activities to determine whether anticipated results had been achieved. We found that 27 projects valued at about $30 million did not achieve anticipated results. For example, the Watervliet Arsenal purchased three bed mills in fiscal year 1985 for about $1.4 million. Watervliet estimated that the bed mills would achieve benefits of about $271,000. The post-investment analysis performed by the Arsenal for the period July 1, 1986, through June 30, 1987, showed that actual benefits were about $199,000, or $72,000 less than estimated. The lower benefits were due to differences between estimated work load projections and actual use of the equipment.

The Army Audit Agency made similar observations regarding projects not achieving expected results. The Agency found that the Army had estimated the benefits for 26 projects at $5.2 million, although the projects had achieved only $2.8 million, or 54 percent, of the expected benefits. The benefits were less than expected primarily because actual work loads were less than estimated. Other reasons were attributed to calculation errors in the cost factors of the project justification.

DOD concurred with our findings that the program was not yet a sound capital investment program. To improve program management it plans to centralize overall program guidance and oversight within the Office of the Assistant Secretary of Defense (Production and Logistics) and issue guidance by the end of December 1989 requiring post-investment analyses on projects. Furthermore, each of the services plans to emphasize to its respective commands and activities the need to comply with existing guidance to ensure that capital investments are consistent with the activities' strategic plans, projects are implemented in a timely manner, and post-investment analyses are being performed. In addition, the services plan to assign more personnel to the program to ensure that guidance is followed and that proper review and analysis is conducted.

INTERNAL CONTROLS NEED TO BE STRENGTHENED

Effective internal controls help managers comply with applicable laws and policies, safeguard assets, and accurately account for revenues and expenditures. Effective internal control systems also provide management with reliable feedback to help ensure that program goals and objectives are met. Because control techniques for the ACP were not followed in some cases, we found that depreciation and property records and project files were inaccurate and inadequate.

For example, we found that at six of the seven activities we reviewed, each had several ACP projects that were either not depreciated or depreciated inaccurately. We found 21 projects costing $16.1 million that were not being depreciated primarily because officials failed to record the items on the depreciation records. In most cases, the equipment had been used for several months.

We also found 41 projects costing $10.3 million that were depreciated inaccurately because (1) projects were depreciated at incorrect values or (2) depreciation expenses were recorded late. As a result, the rates charged by the activities to their customers were incorrect (overstated or understated). Other audit organizations found similar problems with depreciating equipment. For example, the Air Force Logistics Command's Inspector General

reported in March 1988 that equipment at the Sacramento Air Logistics Center costing over $33 million had not been depreciated. In two cases, depreciation started before the equipment was installed. Also, more than 40 items had been fully depreciated, even though they had a substantial service life left. According to the Inspector General's report, the depreciation problems were caused primarily by untimely recording of equipment purchases in the depreciation records.

We also found that three activities' inventory or property control records did not include several equipment items in our sample. Some of these items had been used for some time. For example, the Red River Army Depot property records did not contain information on $9.5 million of equipment purchased as part of a contract for a new light armored vehicle maintenance facility. According to Depot officials, the Corps of Engineers was responsible for contracting out for the construction of the facility and the procurement of equipment. However, the officials said that the Corps never provided it with listings of the equipment and they did not followup to find out what the Corps had purchased. After our review, Red River obtained the equipment listings, verified that the equipment was purchased, and began recording the items on its property records.

DOD concurred with our findings on internal control weaknesses. It said that each of the services plans to review and revise, as

necessary, their directives to (1) ensure compliance with existing internal control procedures and (2) verify that actual costs of equipment are recorded on depreciation and property records. The services also plan to ensure that internal control procedures are being followed.

OTHER FACTORS AFFECTING PROGRAM EXECUTION

Under the original ACP concept, the activities were to implement their programs since they would best be able to determine their modernization needs and focus program funds on those projects that contribute most significantly toward fulfilling its missions. Since the program's inception, however, two factors--nondiscretionary service- and command-directed purchases, and budgeting based on obligation rates--have affected the activities' abilities to execute the program in a manner consistent with OSD's original intent.

Nondiscretionary Purchases

Nondiscretionary purchases--projects directed by service commands or headquarters--have limited the activities' buying power. The amount of nondiscretionary obligations at the seven activities we visited increased from about $3.5 million in fiscal year 1983 to about $23.2 million in fiscal year 1987.

These figures are conservative because we found projects that had not been reported, and others where the values of the projects had been understated. For example, the Mare Island Shipyard was directed to purchase a security system that increased from approximately $278,000 to about $529,000, yet the project was listed at its originally estimated cost.

Officials at the Red River Army Depot, Mare Island Naval Shipyard, and Sacramento Air Logistics Center indicated that their discretionary buying power has been affected by the increasing number of nondiscretionary projects that receive higher funding priority and congressionally mandated budget reductions. They expect their discretionary funding to continue to decline. For example, the Mare Island Naval Shipyard used about $25 million of $88 million, or about 28 percent, for nondiscretionary items between fiscal years 1983 and 1987. Two projects (special hull treatment enclosures for submarines and nuclear refueling equipment) comprised about $19 million, or 76 percent, of the total nondiscretionary purchases. According to the ACP coordinator, as a result of nondiscretionary purchases, the amount of ACP funds for machine tool purchases had decreased from about 60 to 20 percent. The situation at Mare Island is expected to continue. For fiscal years 1988 through 1992, the Shipyard expects that about $22.7 million, or 32 percent, of its ACP budget will be for nondiscretionary purchases, including a $3.3 million production management information system.

Information we obtained from the Naval Air Systems Command in response to our April 1988 report further illustrates the impact of nondiscretionary purchases. Command officials stated that increasing requirements for information systems such as the Rapid Acquisition of Manufactured Parts, Computer Aided Design 2, and Engineering Data Management Information and Control Systems raise questions as to the adequacy of ACP funding levels. According to these officials, projected depot funding levels for fiscal years 1989 and beyond are insufficient to support both the management information system requirements and plant equipment investment requirements developed by the depots. They suggested that either additional ACP funds be made available or consideration be given to fund information system requirements from sources other than the ACP.

Budgeting Based on Obligation Rates

According to OSD officials, activities are to request ACP funds only for the amounts that can be obligated in the budget execution year. The commands' obligation rates are one determinant of the appropriateness of their ACP budget allocation. The services perceived this to mean that they were to obligate their ACP funds within the budget execution year or lose them and communicated this to their respective commands and activities.

The services reduced the budgets for the commands and activities we visited by about $30.9 million between fiscal years 1986 and 1988 based on prior obligation rates. For example, the Army Audit Agency reported that the Army reduced the Depot System Command's budget authority by $13.7 million and $12 million in fiscal years 1987 and 1988, respectively, because the Command had not met its obligation goals. The Army Audit Agency data showed that only 53 percent of the Command's fiscal year 1988 budget authority had been obligated by March 31, 1988, when the Command wanted to have 75 percent obligated by that date.

As we reported in April 1985[5], the Navy did not have its budget reduced due to low obligation rates because it reported commitments rather than obligations. For example, at the end of fiscal year 1987, the Norfolk Naval Shipyard reported that 99 percent of its $47 million budget authority had been obligated when only 3 percent was actually obligated.

To avoid losing funds, some activities substituted lower priority items for higher priority items because they were readily available from commercial sources. For example, in fiscal year 1986, the Red River Army Depot had about $1.1 million that became available for obligation in August 1986 because it cancelled a project. With 2 months remaining in the fiscal year, Red River purchased lower

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[5]Navy Maintenance: Naval Aviation Depots' Asset Capitalization Program Needs Improvement (GAO/NSIAD-88-134, Apr. 28, 1988).

priority items, such as modular furniture, for about $17,000 in lieu of higher priority items, such as a shearing machine, a robotic welder, and a grinder. The Depot did not have sufficient time remaining in the fiscal year to contract for these items.

PROGRAM OVERSIGHT

A significant amount of ACP funds were associated with several nondiscretionary projects. However, key congressional committees have limited visibility over the amount of funds directed toward these purchases.

The Congress recently became concerned about the information it receives on ACP purchases. In October 1987, the House Committee on Appropriations directed OSD to provide, beginning with its fiscal years 1988 and 1989 biennial budget estimates, annual budget exhibits showing how ACP funds are used, particularly for large dollar volume items in excess of $1 million.

In accordance with the guidance, the exhibits only cover the fiscal years 1987 and estimated 1988 and 1989 time period. The exhibits do not provide the total cost of a project through its completion. This information may be useful to the Congress in deciding the impact of the item's procurement on the ACP and the industrially funded activities. For example, Air Force exhibits show that the cost of its Depot Maintenance Management Information System is

about $51 million for fiscal years 1987 through 1989. Air Force data show that the total cost of this system through fiscal year 1999 is expected to exceed $275 million.

We believe that DOD could, with minimum effort, include total project costs in the ACP exhibits that are provided to your Committee as part of DOD's annual budget submissions.

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In summary, Mr. Chairman, we believe the ACP offers great potential for Defense activities to modernize their repair and manufacturing operations. There are a number of management problems, however, that need to be corrected for the ACP to achieve this objective in a cost-effective manner.

-- OSD has not provided comprehensive guidance for what can be purchased with program funds and existing guidance does not specifically identify OSD's intent for program execution.

-- The services have not adequately implemented the elements of a sound capital investment management program--including providing adequate management support; well-defined program criteria for justifying, reviewing, and approving projects; and post-investment analyses.

-- The services lacked or failed to follow internal control procedures designed to accurately account for and safeguard capital equipment.

DOD has informed us that it has plans to correct the problems we identified. We believe that these actions, if properly implemented, will improve the management of the program and provide the focus and direction needed to achieve the objectives for which the program was intended.

This concludes my prepared statement. I would be pleased to respond to any questions you may have.