United States General Accounting Office

GAO

Report to Congressional Requesters

April 1991

INDUSTRIAL FUNDS

Weakness Remain in the Department of Defense's Capital Equipment Program

GAO/NSIAD-91-175

GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-243370

April 17, 1991

The Honorable Daniel Inouye
Chairman
The Honorable Ted Stevens
Ranking Minority Member
Subcommittee on Defense
Committee on Appropriations
United States Senate

As you requested, we reviewed several aspects of the Department of Defense's (DOD) management of the Asset Capitalization Program (ACP) to supplement the information we provided you in our June 1990 report.[1] As agreed with members of your staff, our objectives were to:

- review DOD's plans to request that the Congress transfer funding for industrial/depot maintenance equipment back to the industrial funds effective in fiscal year 1992, and determine whether DOD has corrected, or plans to correct, the management weaknesses we identified in our August 1989[2] and June 1990 reports regarding the program;
- determine the extent to which DOD's industrial fund accounting and reporting procedures allowed DOD to use unexpended ACP funds to pay for losses in the industrial fund operations and to make refunds to their customers; and
- determine whether the unliquidated ACP obligations are appropriately included as liabilities in DOD's computation and reporting of net budgetary resources for its industrial funds, as required by the Anti-Deficiency Act.

DOD's fiscal year 1992 budget submission to the Congress includes a proposal to create a Defense Business Operations Fund and to finance capital equipment through this fund similar to the way the ACP was funded from fiscal years 1983 through 1989. Although this proposal is not yet fully developed, we reviewed DOD's plans to finance capital equipment through this fund, as they relate to our prior ACP reviews.

[1] Industrial Funds: The Department of Defense's Management of ACP Funds (GAO/NSIAD-90-202FS, June 28, 1990).

[2] Plant Modernization: DOD's Management of the Asset Capitalization Program Needs Improvement (GAO/NSIAD-89-147, Aug. 4, 1989).

Background

In 1983, DOD established the ACP to modernize plant and industrial equipment at industrially funded activities. Under the program, the activities purchased capital equipment with industrial funds rather than direct appropriations. The activities recovered the cost of equipment by including depreciation expense in the charges to their customers for work performed and, in some years, surcharges when the depreciation charges were not sufficient to fully fund the program.

In fiscal year 1990, the Congress terminated the ACP and transferred funding for capital equipment at the industrial fund activities back to the services' procurement appropriations.

DOD is currently planning to fund capital equipment at industrial fund and stock fund activities through the proposed Defense Business Operations Fund, beginning in fiscal year 1992. In addition to consolidating the current industrial and stock funds, the proposed fund is designed to capture and reflect all of the direct costs required to support the individual activities and to include these costs in the rates that the activities charge their customers. If the Congress approves this proposal, the capital equipment, military construction, and management information systems at these activities would be funded through the customer rates, similar to the way the ACP was funded from fiscal years 1983 through 1989.

Results in Brief

DOD's proposal to fund capital equipment at industrial fund activities through the Defense Business Operations Fund does not adequately address the ACP weaknesses identified in our prior reports. The congressional decision to fund this equipment through the procurement appropriations in fiscal years 1990 and 1991 has provided the Congress with greater visibility and control over the funds. For example, the Congress appropriated funds for specific capital equipment, and DOD was precluded from using those funds for any other purposes. However, neither this funding approach nor the proposed Defense Business Operations Fund eliminates the need for better policies and guidance for the capital equipment program.

In our August 1989 report, we concluded that the ACP did not have all the essential elements of a sound capital investment management program. Specifically, we reported that the ACP needed stronger management involvement and support; a more systematic approach for identifying projects needed to satisfy technology and strategic long-range planning requirements; better procedures to justify, review, and approve ACP projects; better planning and timing for project implementation; and improved procedures to measure program benefits. We also reported that the ACP lacked adequate accounting policies and internal control procedures. Although DOD agreed with the recommendations in that report and promised corrective actions, it has not implemented any corrective actions. For example, DOD's fiscal year 1991 capital equipment budget submission to the Congress lacked strategic planning and did not reflect DOD's long-term requirements for modernizing its industrial fund activities. Furthermore, DOD has not established requirements or procedures for performing post-investment analyses to document the cost-effectiveness of equipment that it has purchased.

DOD's industrial fund accounting procedures did not prohibit the industrial funds from using ACP revenues to pay for non-ACP expenses. This policy contributed to reporting of inaccurate and insufficient information on the program for oversight and decision-making. For example, because these accounting procedures did not require reserving the portion of ACP revenues necessary for future disbursements, the industrial funds had about $1 billion worth of unliquidated ACP obligations as of September 30, 1989, without any ACP cash reserves to pay for these obligations. Therefore, the industrial fund activities had to use general operating revenues to pay for these obligations beginning in fiscal year 1990, which contributed to cash shortages in the industrial funds. These cash shortages and the lack of ACP reserves prevented DOD from complying with congressional guidance to refund about $519.3 million in depreciation-related revenues to the industrial fund customers in fiscal year 1990. In addition, annual reports submitted to the Congress contained inaccurate information on ACP cash requirements and did not provide sufficient information on the status of the program, such as ACP revenues, disbursements, and obligations, to allow DOD and the Congress to make effective funding decisions.

DOD's five industrial funds are subject to the Anti-Deficiency Act, which prohibits the expenditure or obligation of funds exceeding the amount of available budgetary resources. Although we did not find any violations of the act, comptroller officials at each of the military services' headquarters were unable to document that the unliquidated ACP obligations were included in the computations of the industrial funds' budgetary resources. Based on our limited analysis, however, unliquidated ACP obligations appear to be appropriately included.

Recommendations

We recommend that the Secretary of Defense revise the policies and guidance for the capital equipment program, regardless of how it is funded, to address the ACP weaknesses we reported in August 1989. Specifically, we recommend that the Secretary of Defense

- establish clear guidance to ensure that (1) capital investments are consistent with strategic plans, (2) project planning addresses timely installation and operation of equipment upon receipt at industrial fund activities, and (3) adequate internal control procedures are followed; and
- require post-investment analyses or other measures to determine if anticipated benefits are realized and if changes in program management are needed.

Matters for Congressional Consideration

If the Congress approves DOD's proposal to fund capital equipment through the Defense Business Operations Fund, the Congress may wish to consider requiring DOD to

- reserve unexpended equipment funds to pay for future disbursements associated with unobligated balances and unliquidated obligations,
- establish appropriate accounting and reporting procedures for the capital equipment included in the Defense Business Operations Fund, and
- include in the DOD annual budget submission to the Congress a financial summary identifying the status of the capital equipment program.

This financial summary should provide all appropriate data elements needed to facilitate congressional oversight, including (1) unobligated balances and unliquidated obligations at the beginning and end of the fiscal year, (2) equipment obligations during the fiscal year, (3) disbursements for capital equipment during the fiscal year, and (4) amount of the total cash balance in the Defense Business Operations Fund that should be placed in a reserve account to fund future disbursements associated with unobligated balances and unliquidated obligations.

As requested, we did not obtain official agency comments on this report. However, we discussed a draft with cognizant DOD and military service officials and incorporated their comments where appropriate. DOD officials remain opposed to retaining cash reserves for unliquidated capital equipment obligations and unobligated balances. These officials believe that establishing separate reserve accounts would unnecessarily limit the use of available resources to meet valid industrial fund requirements. We believe, however, that by not retaining these reserves, DOD could continue to inappropriately use unexpended capital equipment funds to make refunds or to meet other operational expenses. DOD officials also noted that they are considering our prior recommendations in developing the policies and procedures for the proposed Defense Business Operations Fund. To adequately address the weaknesses identified in our prior reports, they hope to complete these policies and procedures by the fourth quarter of fiscal year 1991.

Our findings are discussed in more detail in appendix I, and our objectives, scope, and methodology are discussed in appendix II. As you requested, a listing and synopsis of related GAO reports are provided in appendix III.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 5 days from its issue date. At that time, we will send copies to the Chairmen, Senate Committee on Governmental Affairs, House Committee on Government Operations, House Committee on Appropriations, and Senate and House Committees on Armed Services; the Director, Office of Management and Budget; and the Secretaries of Defense and the Army, Navy, and Air Force. We will also make copies available to others on request.

If you have any additional questions, please contact me on (202) 275-8412. Major contributors to this report are listed in appendix IV.

Donna Heivilin

Donna M. Heivilin
Director, Logistics Issues

Contents

Abbreviations

ACP	Asset Capitalization Program
DOD	Department of Defense
GAO	General Accounting Office

Previously Reported Weaknesses Remain in the Department of Defense's Capital Equipment Program

Funding Proposal for Capital Equipment Does Not Address Prior Program Weaknesses

The Department of Defense (DOD) has proposed funding capital equipment at industrial fund and stock fund activities through the Defense Business Operations Fund, beginning in fiscal year 1992. Under this proposal, capital equipment at these activities would be managed similar to the way it was under the Asset Capitalization Program (ACP) from fiscal years 1983 through 1989. We found, however, that DOD's capital equipment policies and guidance still lack adequate controls to correct longstanding problems identified in our previous reports.

Funding this equipment through the services' procurement accounts in fiscal years 1990 and 1991 has alleviated some of the ACP accounting and reporting weaknesses we previously reported, but has not eliminated the need for better policies and guidance for the capital equipment program. In our opinion, adoption of DOD's proposal to fund capital equipment through the Defense Business Operations Fund, prior to correcting the previously reported weaknesses, could continue the abuses and poor management practices we found with the ACP.

DOD's Proposal for a Defense Business Operations Fund

According to a comptroller official from the Office of the Secretary of Defense, the proposed fund would include all of the activities now financed through the industrial and stock funds, as well as several other support activities. This official said that the line items included in the fund's operations budget are not intended to vary significantly from those that have historically been included in the operations budgets for the industrial funds. However, the proposed capital budget would include line items previously funded from procurement and military construction appropriations, such as procurement of equipment, development of information systems, and major construction and repair of facilities.

DOD's proposal for funding the line items in the capital budget is similar to the way the ACP was funded. Specifically, Defense Business Operations Fund activities would include depreciation in the rates they charge their customers, which DOD expects would generate sufficient revenue to pay the full costs of the line items in the capital budget.

Capital Equipment Accounting and Management Weaknesses Persist

Over the past 5 years, we have issued four reports on weaknesses in DOD's accounting and management of the ACP. These weaknesses resulted from a lack of strategic objectives, inadequate guidance and direction, and insufficient accounting policies and procedures. During our current review, we found that DOD had not adequately corrected these reported weaknesses and that many of these weaknesses remain. Although funding capital equipment through the services' procurement appropriations in fiscal years 1990 and 1991 improved visibility over program funds, neither this method of funding nor the proposed Defense Business Operations Fund has eliminated the need for improved program management. Therefore, we believe that the previously reported weaknesses could continue if the Congress approves DOD's current Defense Business Operations Fund proposal.

In May 1986,[1] we reported that the DOD industrial fund activities were commingling ACP funds with other industrial fund revenues and that there were no controls to preclude the industrial funds from using ACP revenues to pay for general operating expenses. Consequently, we recommended that DOD establish formal ACP accounting procedures and consider establishing separate reserve accounts for actual ACP revenues, obligations, and expenditures.

In June 1990, we reported that DOD had not implemented these recommendations and was still commingling ACP funds with other industrial fund revenues. Furthermore, the industrial funds had been using ACP revenues to pay for other industrial fund operations, such as salaries, materials, and overhead. As a result, the industrial funds had sustained unliquidated ACP obligations of about $1 billion as of September 30, 1989, but did not have any monies set aside to pay for these obligations. Beginning in fiscal year 1990, an Office of the Secretary of Defense comptroller official stated that the industrial funds have had to use general operating revenues to pay for these ACP obligations.

In our April 1988 report,[2] we concluded that the ACP at two naval aviation depots lacked management support, well-defined program criteria, and post-investment analyses. In that report, we recommended that the Navy develop guidance for effective program management and establish oversight procedures to measure program achievements.

Furthermore, in our August 1989 report, we identified similar weaknesses in the ACP throughout the DOD industrial funds. We reported that the ACP suffered from unclear program guidance, inadequate compliance with existing guidance, and inadequate implementation of elements of a

[1] Industrial Funds: DOD Should Improve Its Accounting for Asset Capitalization Program Funds (GAO/NSIAD-86-112, May 23, 1986).

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

sound capital investment management program. We also identified several internal control problems, including inadequate equipment depreciation accounting and inadequate procedures to ensure the safeguarding of assets.

Although DOD generally agreed with the findings and recommendations in our prior reports and promised corrective actions, it has not corrected the ACP weaknesses. In response to our recommendations, a DOD Maintenance Policy official stated that DOD started to revise its ACP instruction in April 1990. We found, however, that this revision was never completed or implemented. In June 1990, DOD reported that it had discontinued its efforts to address the findings and recommendations in our August 1989 report. The response stated that, because the Congress had discontinued the ACP in the industrial funds and transferred the funding to the procurement appropriations, DOD regarded our recommendations as no longer germane. Subsequently, in response to a draft of this report, DOD officials stated that they plan to address our prior findings and recommendations in their implementing policies and procedures for the proposed Defense Business Operations Fund.

Accounting and Reporting Procedures Did Not Preclude Using ACP Funds to Pay for Other Industrial Fund Operations

Inadequate industrial fund accounting and reporting procedures contributed to inappropriate decisions to refund unexpended ACP revenue to customers and to fund operational losses. These procedures have not provided the visibility needed for effective oversight of the ACP program. The accounting system did not prohibit the industrial funds from commingling ACP revenues with other operational income and did not require the industrial funds to retain reserves to pay for future ACP expenditures. Moreover, the industrial funds' reporting system did not provide sufficient information to allow service, Office of the Secretary of Defense, and congressional officials to make effective ACP funding decisions. As a result, budget decisions may have been made without knowing the amount of ACP revenues needed for future disbursements associated with the unliquidated ACP obligations and unobligated balances.

Due to concerns over DOD's management of the ACP, the Congress transferred funding from the industrial funds to the services' procurement accounts beginning in fiscal year 1990 and established specific requirements regarding DOD's use of these funds. Low cash balances in the industrial funds resulting from prior years' operating results and the lack of ACP reserves precluded the industrial fund activities from complying with congressional guidance to refund $519.3 million in depreciation-related revenues collected from customers during fiscal year 1990.

Weaknesses Existed in DOD's Industrial Fund Accounting and Reporting Procedures

The ACP revenues collected annually by the industrial fund activities significantly exceeded the disbursements for that year's ACP obligations. In most cases, the excess revenues were required in future years when the remaining obligations had to be paid. Since DOD accounting procedures did not require industrial fund activities to reserve ACP revenues, the activities were free to commingle ACP revenues with other revenues generated from operations. In our May 1986 report, we recommended that DOD discontinue its practice of commingling funds and retain appropriate ACP reserves required for future disbursements. However, DOD has not implemented this recommendation.

Industrial Fund Overview Reports contained inaccurate information on ACP cash requirements and did not provide sufficient information in other areas to allow DOD and the Congress to make effective funding decisions. The reports inaccurately reflected the portion of the industrial funds' cash balances that would be needed to pay future disbursements associated with the unobligated balances and the unliquidated ACP obligations. For fiscal year 1987, for example, the services' computations of these amounts were understated by as much as $321.9 million for one of the services. Some Office of the Secretary of Defense and service comptroller officials attributed these inaccuracies to the lack of a clear definition regarding the data elements to be included in computing ACP cash requirements.

The overview reports also lacked other program data needed to accurately reflect the status of the ACP. Information was not reported concerning ACP revenues and disbursements for each fiscal year, outstanding unliquidated obligations and unobligated balances, and equipment purchases.

ACP Revenues Were Improperly Used to Fund Operational Losses and Customer Refunds

As a result of customer refunds and operational losses sustained from fiscal years 1987 through 1989, the industrial fund activities had accumulated about $1.6 billion in operating losses and had a decrease in their combined cash balances from $3.5 billion at the end of fiscal year 1986 to $843 million at the end of fiscal year 1989. During this period, the industrial fund activities used accumulated ACP revenues to fund these losses and to make refunds to customers' operations and maintenance accounts. These accumulated reserves, however, were needed in future years to fund the ACP obligations.

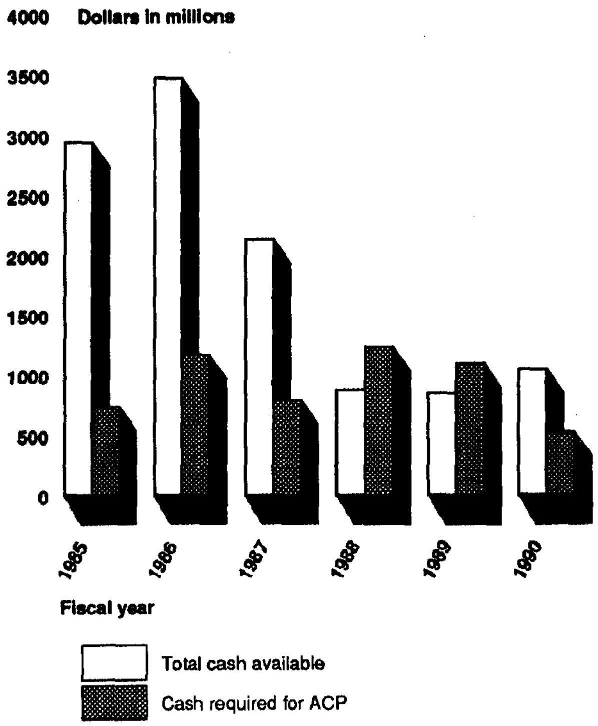
The Congress directed a large refund in fiscal year 1987 to reduce the $3.5-billion cash balance in the industrial funds. This refund, coupled with operational losses in the following 3 fiscal years, reduced the industrial fund activities' cash balances below the level needed to meet current day-to-day operations and to provide reserves for ACP obligations that had to be paid in future years. Consequently, DOD made a conscious decision to (1) use the available cash balances, which included the accumulated ACP revenues, to meet current year expenses and (2) rely on future year ACP revenues to pay for the unliquidated ACP obligations.

According to DOD officials, during the fiscal year 1987 budget review process, the Office of the Secretary of Defense and the Congress directed that the industrial fund activities refund approximately $1.5 billion to their customers' operations and maintenance accounts. At this time, the industrial fund activities needed $1.3 billion to meet ACP obligations, leaving about $700 million for day-to-day operations.

The industrial fund activities sustained operating losses from fiscal years 1987 through 1989. DOD's industrial fund activities had reported positive operating results for fiscal years 1985 and 1986. Figure I.1 shows both the net and accumulated operating results for fiscal years 1985 through 1990. Net operating results is a measure of the excess or shortage of revenues over costs and surcharges. Accumulated operating results is the cumulative impact of net operating results over a period of years, as well as adjustments for refunds, cash infusions from the operations and maintenance accounts, and supplemental appropriations. According to an Office of the Secretary of Defense comptroller official, these operating losses significantly drained the activities' cash levels. For fiscal years 1988 and 1989, the industrial fund activities did not have enough cash to sustain current year operational expenses and provide reserves for ACP obligations that had to be paid in future years. By the end of fiscal year 1989, available cash had decreased to $843 million, as shown in figure I.2. We reported in June 1990 that, from fiscal years 1983 through 1989, $4.8 billion was collected for the ACP, while $4 billion was disbursed for ACP-related contracts. The remaining $800 million, which should have been used for future ACP obligations, was spent on other industrial operations, such as salaries, materials, and overhead.

Figure I.1: Industrial Funds' Operating Results for Fiscal Years 1985 Through 1990

Figure I.2: Cash Required for ACP Compared to Total Cash Available



These ACP revenues provided the industrial fund activities the cash needed to sustain operations, because revenues generated from operations were insufficient to meet expenses. However, according to service comptroller officials, the lack of ACP reserves was not a concern as long as the ACP remained in the industrial funds. These officials said that DOD operated under the premise that future ACP revenues would be available to meet these prior-year obligations.

Cash Shortages Precluded Customer Refunds Proposed by the Congress During Fiscal Year 1990

Low cash balances in the industrial funds and the lack of ACP reserves precluded the industrial fund activities from making refunds to customers in fiscal year 1990 as proposed by the Congress. In conjunction with transferring ACP funding from the industrial funds to the services' procurement appropriations, the Congress directed that DOD use existing revenues in the industrial fund accounts to meet prior-year ACP obligations. Since the projected rate structures were not altered to account for the change in funding, the Congress proposed that the $519.3 million in depreciation-related revenue be refunded to the customers' operations and maintenance accounts by the end of the fiscal year.

DOD comptroller officials noted that cash balances were so low that refunding the money would have affected the overall operations of the various activities. Even though DOD could not document the minimum cash balances needed to sustain its industrial fund operations, an Office of the Secretary of Defense comptroller official estimated the amount would be about $600 million. He added that during the fiscal year, cash balances at several industrial fund activities fell below the levels that officials believed were needed to sustain operations.

At the end of fiscal year 1990, industrial fund activities had sustained a combined operating loss of $321.9 million and had a combined cash balance of $1.05 billion. Of this total cash balance, about $523 million was required for unliquidated ACP obligations. This left about $526 million for operations, which was $74 million less than the $600 million DOD estimated the activities needed for operational expenses. The Office of the Secretary of Defense comptroller official noted that current cash balances were at the absolute minimum levels needed to sustain normal operations.

Industrial Fund Budgetary Resources Appropriately Include Unliquidated ACP Obligations

DOD did not require its industrial fund activities to reserve unexpended ACP funds to pay unliquidated ACP obligations and allowed these activities to commingle the funds with other industrial fund assets. As a result, the Subcommittee on Defense, Senate Committee on Appropriations, was concerned that DOD (1) may have violated the Anti-Deficiency Act by allowing its industrial activities to overobligate their available budgetary resources and (2) may have not included its unliquidated ACP obligations in computing available budgetary resources. Although we did not find any Anti-Deficiency Act violations, officials at each of the military services' headquarters were unable to document that the unliquidated ACP obligations are included in the computations. However, our tests at one industrial fund activity and limited data we obtained from command levels indicate that the unliquidated ACP obligations appear to be appropriately included.

Compliance With the Anti-Deficiency Act

The Anti-Deficiency Act prohibits industrial fund officials from making or authorizing an expenditure or obligation exceeding an amount available in the funds for that transaction. According to the Office of Management and Budget, available budgetary resources include cash on deposit with the Treasury, accounts receivable, and unfilled customer orders on hand less obligations incurred. The services and defense agencies compute the available budgetary resources for the five industrial funds monthly and report these levels to various organizations including the service headquarters, the Office of the Secretary of Defense, and the Office of Management and Budget.

To determine whether the industrial funds had potentially violated the requirements of the act, we reviewed the reported balances of budgetary resources for the four largest industrial funds. As shown in table II.1, none of these industrial funds had incurred obligations in excess of their resources as of September 30, 1989.

Table II.1: Balances of Budgetary Resources as of September 30, 1989

	Army	Navy	Air Force	Marine Corps
Total budgetary resources	$4,262.5	$15,460.8	$5,658.6	$162.2
Obligations incurred	3,403.2	15,165.3	5,631.6	109.4
Total unobligated balance available	**$859.3**	**$295.5**	**27.0**	**52.8**

Unliquidated ACP Obligations Are Not Separately Identified

DOD's standard format for monthly reports on the industrial funds' available budgetary resources did not separately identify ACP transactions. As a result, service headquarters officials did not have information on the amount of unliquidated ACP balances, nor could they document whether these unliquidated balances had been used in computing their available budgetary resources. However, after requesting this information from their subordinate financial organizations, the services were able to compute their unliquidated ACP obligations, which totaled about $1 billion as of September 30, 1989.

According to comptroller officials at the services' headquarters, these unliquidated balances were appropriately included in reports of available budgetary resources, but they could not provide corroborating documentation. Officials at lower command levels agreed that unliquidated ACP obligations had been routinely included in their monthly reports, though not as a separate line item. For example, officials at the Air Force Accounting and Finance Center in Denver, Colorado, said that, while the unliquidated ACP obligations were not consolidated into easily identifiable line items on the report, they were able to reconstruct the amounts by extracting data from several ACP obligation accounts.

Because we could not independently verify the statements made by these officials, we visited an industrial fund activity at the Naval

Weapons Station in Yorktown, Virginia, to determine whether unliquidated ACP obligations were appropriately represented and accounted for in their respective financial statements and supporting financial records. These obligations had been presented on the station's fiscal year 1989 financial statements and were separately identified in the accounting records.

According to officials in the station's Office of Comptroller, for example, unliquidated ACP obligations for capital equipment ordered but not delivered were included as obligations in the "undelivered orders" caption of the financial statement. These officials stated that the station's policies require that the unliquidated ACP obligations be included in the financial statements, although no such guidance had been received from the Office of the Navy Comptroller. We traced the records of undelivered ACP equipment orders in the financial statements and found that they were appropriately identified as obligations in the subsidiary records.

Objectives, Scope, and Methodology

The objectives of our review were to:

- review DOD's plans to request that the Congress transfer funding for industrial/depot maintenance equipment back to the industrial funds effective in fiscal year 1992, and determine whether DOD has corrected, or plans to correct, the management weaknesses we identified in our August 1989 and June 1990 reports regarding the Asset Capitalization Program;
- determine the extent to which DOD's industrial fund accounting and reporting procedures allowed DOD to use unexpended ACP funds to pay for losses in the industrial fund operations and to make refunds to their customers; and
- determine whether the unliquidated ACP obligations are appropriately included as liabilities in DOD's computation and reporting of net budgetary resources for its industrial funds, as required by the Anti-Deficiency Act.

To address the first objective, we reviewed relevant DOD fiscal year 1992 budget guidance, a draft revision to the ACP instruction, and documentation related to the proposed Defense Business Operations Fund. Additionally, we met with DOD officials and reviewed various documents to assess the extent to which management weaknesses noted in our prior reports had been corrected. To address the second objective, we analyzed industrial fund budget and accounting data for fiscal years 1983 through 1990, reviewed annual Industrial Fund Overview Reports, and interviewed comptroller officials at the Office of the Secretary of Defense and the services. For the third objective, we reviewed budget and accounting data obtained from each of the services and discussed computation and reporting procedures for net budgetary resources with agency officials. We also conducted a test of these procedures at the Yorktown Naval Weapons Station.

We performed our work at the following locations:

- Office of the Secretary of Defense, Washington, D.C.;
- Departments of the Army, Navy, and Air Force, and Marine Corps Headquarters, Washington, D.C.;
- Comptroller of the Defense Logistics Agency, Alexandria, Virginia;
- Air Force Accounting and Finance Center, Denver, Colorado; and
- Yorktown Naval Weapons Station, Yorktown, Virginia.

We conducted our review from August 1990 to December 1990 in accordance with generally accepted government auditing standards.

Summary of Related GAO Reports

Industrial Funds: DOD Should Improve Its Accounting for Asset Capitalization Program Funds (GAO/NSIAD-86-112, May 23, 1986).

The ACP used industrial funds to finance the acquisition of industrial plant equipment, which resulted in increased funds for acquiring this equipment. However, the ACP was in its fourth year without formal ACP accounting guidance, and DOD's current accounting procedures did not separate ACP funds from those generated through charges to customers for other goods or services provided. Consequently, DOD did not have the financial data to ensure that funds would be available for the procurement of equipment when needed or that the financial position of the industrial funds would not affect equipment procurement decisions. Further, information on ACP, reported to the Congress in DOD's annual industrial fund overview reports, was not sufficient to assure the Congress that legislatively mandated program requirements were being met.

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

Between fiscal years 1983 through 1987, the naval aviation depots were authorized $384 million for plant modernization under the ACP. However, many purchases had not achieved expected benefits. The Navy needed to develop guidance for effective program management and to establish oversight procedures to ensure program achievements within the aviation depots. In addition, generally accepted elements of an effective capital investment program, such as management support, well-defined program criteria, and post-investment analyses, were needed. Other specific areas of concern relative to internal controls and budget execution were that (1) controls for depreciation accounting and the safeguarding of assets had not been followed and (2) program funding had significantly exceeded the level obligated by the end of the budget year.

Plant Modernization: DOD's Management of the Asset Capitalization Program Needs Improvement (GAO/NSIAD-89-147, Aug. 4, 1989).

Between fiscal years 1983 and 1989, about $5 billion had been approved for plant modernization at DOD's industrial fund activities. Although the program offered great potential as a technique for financing projects needed to modernize the industrial fund activities' operations, many projects had not achieved expected benefits because of (1) unclear program guidance, (2) inadequate compliance with existing guidance, and

(3) inadequate implementation of elements of a sound capital investment management program. In addition, the program experienced several internal control problems, including inadequate equipment depreciation accounting and inadequate procedures to ensure the safeguarding of assets. Furthermore, an increasing number of command- and service-directed projects were using a significant amount of program funds, and the services believed that if they did not obligate all the equipment funds within the budget execution year they would lose them. As a result, some activities bought lower priority equipment to avoid losing program funds, and the Congress had limited visibility over the costs of large service-and command-directed projects and their impact on the program.

Industrial Funds: The Department of Defense's Management of ACP Funds (GAO/NSIAD-90-202FS, June 28, 1990).

Data provided by the Office of the Secretary of Defense and the military services indicated that during fiscal years 1983 through 1989, DOD's industrial fund activities had obligated about $5 billion for ACP contracts but had disbursed only about $4 billion to liquidate these obligations. As a result, about $1 billion of ACP obligations remained unliquidated as of September 30, 1989.

DOD's policies did not require the industrial fund activities to retain the unexpended ACP funds or to establish cash reserves to pay unliquidated obligations. Consequently, DOD officials told us that the industrial fund activities commingled the unexpended ACP funds with other industrial fund cash balances and spent these funds on other industrial operations. DOD officials also acknowledged that because cash reserves were not established to pay the unliquidated ACP obligations, prior year obligations were being funded with current year revenues.

Major Contributors to This Report

National Security and International Affairs Division, Washington, D.C.

Victor Zangla, Assistant Director
Gene H. Dechert, Senior Evaluator

Norfolk Regional Office

Harry E. Taylor, Jr., Regional Management Representative
David A. Schmitt, Evaluator-in-Charge
Robert L. Self, Site Senior
Sally L. Coleman, Evaluator

Ordering Information

The first five copies of each GAO report are free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20877

Orders may also be placed by calling (202) 275-6241.

United States
General Accounting Office
Washington, D.C. 20548

Official Business
Penalty for Private Use $300

First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100