096399 C+DP-5

LAST COPY

73-0456

REPORT TO THE CONGRESS

LM096399

file

Revisions Needed In Financial Management Policies Of The Federal Government's Automatic Data Processing Fund

B-115369

Office of Management and Budget
General Services Administration

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

APRIL 17, 1973

~~01496~~ 096399

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

B-115369

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on revisions needed in financial management policies of the Federal Government's Automatic Data Processing Fund administered by the Office of Management and Budget and the General Services Administration.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget, and to the Acting Administrator of General Services.

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

ADP	automatic data processing
GAO	General Accounting Office
GSA	General Services Administration
OMB	Office of Management and Budget

CHAPTER 1

INTRODUCTION

LEGISLATIVE PROVISIONS FOR THE FUND

The Congress enacted Public Law 89-306 (Brooks Bill) in October 1965 to provide a Government-wide program for the economic and efficient acquisition, utilization, and maintenance of automatic data processing (ADP) equipment. The law made the Office of Management and Budget (OMB) responsible for fiscal and policy control and the General Services Administration (GSA) responsible for operations. To assist in achieving the program's objectives, the law authorized that an ADP fund be established.[1]

The legislative history of Public Law 89-306 shows that implementation of the Government-wide program was expected to be gradual. The first step was to be the implementation of a comprehensive inventory system. As a second step, GSA was to seek appropriations and set up the ADP fund. The third step was to transfer to the fund the general-purpose ADP equipment of all Federal agencies. When the fund was fully implemented, GSA was expected to use it to acquire all general-purpose ADP equipment which the agencies needed. Charges to agencies for equipment and services were to approximate the fund's costs, including the capitalized value of equipment transferred to the fund.

The law provided that fund capital be composed of appropriations and the value, as determined by the Administrator of General Services, of transferred equipment. The Congress capitalized the fund with an initial appropriation of $10 million in November 1967 and an additional appropriation of $20 million in January 1971. The fund's financial statements, as of June 30, 1972, showed that the total Government investment had increased to $45.8 million as the result of revaluations of purchased equipment, values assigned to transferred equipment, and miscellaneous items.

---

[1]Fund activities were discussed in a previous GAO report entitled "Multiyear Leasing and Government-wide Purchasing of Automatic Data Processing Equipment Should Result in Signigicant Savings" (B-115369, Apr. 30, 1971).

OMB GUIDELINES FOR THE FUND

In May 1968 OMB issued guidelines to GSA on using the fund. These guidelines directed GSA to explore possibilities for enabling agencies to obtain ADP equipment and services at reduced costs. The guidelines also directed that the fund be used to promote financing of arrangements for joint use of equipment and related services, and be available for acquiring equipment and supplies. Equipment which the fund acquired was to be capitalized at fair market value. Charges to agencies for using the equipment were to insure the fund's continued solvency and sound financial condition but be lower than those charges incurred under individual lease agreements with suppliers.

CURRENT AND ANTICIPATED STATUS OF THE FUND

The cost of equipment purchased for the equipment lease program totaled $19.1 million as of March 31, 1972. As a result of these purchases, $38.7 million of rent payments to the suppliers of that equipment will be avoided over the 3- to 5-year periods of the agencies' leases with the fund. In addition, the fund has acquired excess Government-owned equipment valued at $1.6 million and has leased it to agencies.

As of April 30, 1972, the fund had entered into 56 equipment lease agreements with various agencies. Of the 56 leases, 44 were active, 7 had not started, 2 had been terminated before the expiration of the lease periods, and 3 had been terminated at the end of the lease periods. Nineteen active leases involved only purchased equipment, 12 involved only Government-owned excess equipment, and 13 involved a combination of excess and purchased equipment.

During hearings held in May 1971 by the Government Activities Subcommittee, House Committee on Government Operations, the Administrator of General Services and the Assistant Director, Organization and Management Systems Division, OMB, said that they expect the fund to expand significantly over the next 3 to 5 years, through the transfer of general-purpose equipment that the agencies owned and lease. As of B.01503

June 30, 1971, 5,961 general-purpose computers, valued at $3 billion, were reported to GSA as being owned or leased by Government agencies. Thus, the expected transfers will significantly increase the fund's assets and its role in managing Government ADP equipment.

CHAPTER 2

REVISIONS NEEDED IN

FINANCIAL MANAGEMENT POLICIES

Certain fund management policies should be revised to comply with the intent of Public Law 89-306 and with the accounting principles prescribed by the Comptroller General for Federal agency use. These policy changes should assist in establishing uniform objective determinations of capitalized values and lease charges for purchased and transferred equipment.

The capitalization of purchased equipment at negotiated amounts which exceed its cost to the fund has augmented the fund in a manner contrary to the intent of Public Law 89-306 and to accounting principles prescribed by the Comptroller General for use by Federal agencies.

Capitalized values of transferred equipment have been based on amounts negotiated as lease charges. When the future large-scale transfers of equipment are accomplished, this procedure could result in inconsistencies in capitalized values and lease charges for the same or similar equipment.

Also, GSA has charged agencies an additional 10 percent of the equipment's capitalized value to provide for anticipated losses due to early lease terminations. The need for this charge is doubtful in view of other steps that may be taken to avoid or minimize such losses. This procedure conflicts with the generally accepted practice of not recognizing losses until equipment is disposed of.

The policies of capitalizing equipment on the basis of negotiations rather than cost and/or providing for anticipated losses due to early lease terminations have resulted in higher lease charges to the agencies and unnecessary agency dissatisfaction with fund administration.

POLICIES FOR CAPITALIZING EQUIPMENT AND ESTABLISHING LEASE CHARGES

Public Law 89-306 provides that the capital of the ADP fund is to consist of appropriated amounts and the value of transferred equipment. Appropriated funds may be used to purchase or lease equipment and to meet costs incurred in administering the fund. The Administrator of General Services is to determine the capitalized value of transferred equipment.

The Accounting Principles and Standards for Federal agencies prescribed by the Comptroller General provide that the primary basis of accounting for purchased equipment is its cost to the agency responsible for its management. Reasonable estimates based on such factors as appraisal values or projected income may be used when incurred costs are not measurable, known or significant, as would be the case for transferred equipment. Reimbursements to the fund for equipment and services are to be made at rates determined by GSA to approximate the fund's costs, including the capitalized values of equipment. In accordance with Public Law 89-306, any net income at the end of the year should be transferred to the Treasury as miscellaneous receipts and any net losses should be carried forward to be recovered from future fund income.

Fund management policies should be revised to comply with the intent of Public Law 89-306 and with acceptable accounting practices.

Capitalization of purchased equipment

During the first several months of the fund's operation, purchased equipment was capitalized on the basis of cost. GSA computed lease charges to cover, over the periods of the leases, the fund's purchase costs and anticipated losses due to early lease terminations. OMB's May 1968 guidelines directed that equipment purchased by the fund be capitalized at an estimated fair market value, as determined by the Administrator of General Services, and that the excess of fair market value over the cost of the equipment be retained to augment the fund's capital.

In implementing these guidelines, GSA established capitalized fair market values on the basis of amounts that agencies were willing to pay for using the equipment. The total amount that an agency is willing to pay has been determined by negotiations between GSA and the agency and includes amounts for the capitalization of equipment, expenses, and anticipated losses due to early lease terminations. This change in the basis for capitalizing purchased equipment was intended to result in dividing, between the fund and the agency, the difference between the purchase price and the rent the agency would have paid if it had rented the equipment from commercial suppliers.

For example, in June 1971 the fund purchased a computer system for $1,671,000, which the Department of the Interior had been renting from the manufacturer since May 1967. The purchase, at that time, enabled the Government to take advantage of purchase credits of $1,256,000, which had accumulated while the equipment was being rented and certain special purchase credits of $230,000.

GSA and the Department negotiated a lease agreement effective July 1971 under which the Department will pay $2,460,000 to the fund over a 60-month period--$264,000 for possible losses due to early lease terminations and other fund expenses and $2,196,000 for the capitalized fair market value of the equipment. Thus, total lease payments to the fund will be $789,000 more than the cost of the equipment. Total lease payments, however, will be $2,046,000 less than the Department would have paid if the fund had not purchased the equipment and the Department had continued to rent from the manufacturer for the period of the lease.

The fund had entered into 20 leases involving purchased equipment as of April 30, 1972, although one was no longer active. The equipment in only 4 of the 20 leases was capitalized at cost. As shown in the following table, the equipment in the other 16 leases was capitalized at values which exceeded costs by about $3.6 million. As a result, the fund's asset and investment accounts have been overstated by that amount.

Effective date of lease		User agency	Cost	Amount capitalized	Increase in asset and investment accounts
			(000 omitted)		
Dec.	1967	Department of Commerce	$ 197	$ 197	$ -
Feb.	1968	Department of Labor	614	614	
May	1968	National Aeronautics and Space Administration and Department of the Interior	991	991	-
Sept.	1968	Department of The Treasury	2,017	2,364	347
Dec.	1968	Civil Aeronautics Board	261	261	(a)
Feb.	1969	Department of Health, Education, and Welfare	161	186	25
Sept.	1969	Department of Commerce	1,076	1,309	233
Oct.	1969	Department of the Navy	54	54	-
Dec.	1969	Department of the Treasury	1,917	2,408	491
May	1970	Department of the Navy	1,483	1,800	317
July	1970	Department of the Navy	477	658	181
May	1971	Defense Intelligence Agency	4,001	4,666	665
June	1971	Veterans Administration	363	506	143
July	1971	Department of the Interior	1,671	2,196	525
July	1971	Veterans Administration	100	125	25
Aug.	1971	Veterans Administration	1,738	2,039	301
Sept.	1971	Department of the Navy	83	101	18
Sept.	1971	Library of Congress	494	628	134
Dec.	1971	Department of Agriculture	1,212	1,366	154
Feb.	1972	Department of Transportation	191	236	45
Total			$19,101	$22,705	$3,604

[a]Increase was only $146.

A pro rata distribution of rent received (in the ratio of the equipment cost to the amount capitalized in excess of cost) shows that as of March 31, 1972, the fund had received from agencies $1.4 million of the $3.6 million attributable to the capitalization of purchased equipment in excess of cost.

In our opinion the capitalization policies for purchased equipment are improper because:

1. Augmenting the fund with the $3.6 million attributable to the capitalization of purchased equipment in excess of costs is not in accordance with the legislative provision that fund capital be composed of appropriations and the value of transferred equipment.

2. Capitalizing purchased equipment at fair market value is contrary to the provision in the "GAO Manual for Guidance of Federal Agencies" that cost, when

known, should be the basis for accounting for property.

3. Since the amounts capitalized are recovered through lease charges, these policies have resulted in charges to users that are contrary to the legislative requirement that charges approximate the cost met by the fund.

Capitalization of transferred equipment

Transferred equipment has been capitalized at negotiated fair market values and leased to other agencies. This practice, which has increased the capital of the fund by about $1.6 million, is in accordance with the legislative provision that transferred equipment be capitalized in the fund at values determined by the Administrator of General Services. However, for future operations, the use of objective criteria rather than negotiation, as discussed in the following section, appears more practical for establishing the equipment's capitalized value.

Establishing lease charges

Lease charges for purchased and transferred equipment generally have been established through negotiations with the users at rates which recover the capitalized values of the equipment over the lives of the leases. This method may result in widely varying charges for similar equipment.

The legislative history of Public Law 89-306 shows that the Congress intended that gradually the fund, rather than the individual agencies, would administer all the Government-owned, general-purpose ADP equipment. Full implementation of this aspect--which GSA envisions within the next 5 years--will require the transfer of thousands of items of ADP equipment to the fund.

The present practice of determining lease charges on the basis of negotiations is likely to be impractical for managing a large number of systems and dealing with numerous customers. Unless objective criteria are developed and used, lease charges could vary widely for similar equipment. Those customers paying higher rates for comparable equipment would have justification for dissatisfaction, particularly since they would be required to obtain their equipment from the fund.

GSA officials, concerned about this problem, have expressed their belief that objective criteria could be developed for establishing all lease charges and for capitalizing transferred equipment.

Charges based on objective criteria need not be directly related to the capitalized values of individual items of equipment but should be designed to recover all fund costs. Such criteria would result in comparable rates to all users for identical or similar equipment, regardless of whether the fund acquired the equipment by purchase or by transfer.

To determine lease charges OMB and GSA could consider equipment costs collectively either in total or by classes of equipment such as large, medium, or small scale systems.

PROVISION FOR EARLY LEASE TERMINATIONS

To reduce the possibility that the fund would lose income in the event of early lease terminations, past lease agreements have provided for negotiating settlements. The negotiations were to consider three factors: (1) unrecovered fund costs, (2) equipment disposal values, and (3) the probability of reusing the equipment elsewhere in the Government.

Fund costs comprise three elements: (1) the unamortized portion of the equipment's capitalized values, (2) administrative expenses, which are calculated as a small percent (about 2 percent) of the equipment's capitalized value, and (3) an allowance for the early termination of leases, which is calculated as 10 percent of the equipment's capitalized value. Treating this allowance as a fund cost has the effect of recognizing losses before they occur.

We believe the fund's procedures for recognizing lease termination losses is inappropriate because the equipment is available for reuse elsewhere within the Government and, if reused, a loss is not incurred; a gain or loss generally should be recognized in accounting procedures when the equipment is sold or otherwise disposed of, not when a lease is terminated. When gains or losses are recognized they should be credited or charged to current operations. Any net income or loss incurred for the year should then be handled in conformity with the provisions of Public Law 89-306. (See p. 9.)

As of March 31, 1972, GSA considered only three leases as having been terminated early. However, in each instance the equipment was available for reuse and most of it was reused under new lease agreements. Thus, GSA's experience through March 31, 1972, had not supported the need for an allowance for early termination of leases.

We believe that the provision for termination losses has unnecessarily increased charges to the user agencies and is not needed. Eliminating the provision appears feasible because:

-- In the event of lease terminations before recovering costs, the fund should be able to avoid or minimize losses as a result of the potential for leasing the equipment to other agencies and the agreement with the agencies to negotiate a settlement.

--Termination losses (determined at the time the equipment is disposed of) can be recovered from future lease charges.

Although some losses may be unavoidable, we believe it is preferable to include these costs as future lease costs, rather than as unknown costs for which funds are collected in advance. Any gains, also determined at the time the equipment is disposed of, should be credited to current operations.

AGENCIES' VIEWS OF
EQUIPMENT LEASE PROGRAM

From the agencies' viewpoints, certain factors reduce the attractiveness of the fund as a source of ADP equipment. Since use of the fund usually depends on actions initiated by the agencies, fund policies should be changed, when feasible, to make the fund more attractive to the agencies.

Our discussions with officials of a number of agencies which had leased equipment from the fund indicated that they recognized the agencies were paying less rent to the fund than they would have paid under rent agreements with commercial suppliers. They said that they would be willing to use the fund again if they could not make desirable purchases with their own funds. They pointed out, however, that when the fund purchases equipment, the full savings do not accrue to the agencies. Further, at the end of the lease periods, even though the agencies have fully reimbursed the fund for the cost of the equipment, the fund will own the equipment and the agencies will have to continue some payments to the fund as long as they use the equipment. Although officials recognized that the fund must recover its costs, they objected to lease charges designed to increase the fund's capitalization.

Several officials objected to the policy of establishing lease charges through negotiations rather than allocations of actual costs or objective criteria. Some officials commented that whether lease terms were favorable to their agencies depended on the skills of their negotiators and that the negotiations with GSA for fund equipment were similar to their dealings with commercial suppliers. If so, the agencies and GSA seems to be incurring administrative costs that might be avoided through a more objective system of determining charges.

Agency dissatisfaction with the equipment lease program was also revealed in a report dated November 8, 1971, on a survey of the management of ADP equipment resources within the Department of Defense. According to the report, prepared by the Deputy Assistant Secretary of Defense, Directorate for Interservice Audits, senior ADP policy officials object to using the fund for reasons similar to those noted during our review. However, the officials recognize that using the fund can result in significant savings. The report stated that the Department could save as much as $30 million annually through the fund's purchase of certain equipment being leased in June 1970.

Agencies also objected to lease charges for excess equipment that the fund had obtained at no cost. Excess equipment has been capitalized at fair market values determined by negotiations between GSA and the prospective users. Agencies tend to regard such negotiations as an effort by GSA to maximize the fund's capitalization at their expense.

Public Law 89-306 provides for increasing the fund's capital with transferred equipment. Agencies' objections to paying lease charges for excess equipment might be reduced, however, if the charges were based on objective criteria rather than negotiations. The policies concerning the capitalization of transferred and purchased equipment, the negotiations of lease charges, and the levying of charges to provide for anticipated losses due to early lease terminations were discussed in preceding sections of this report. We are recommending modifications of these policies which, if adopted, should alleviate most agency complaints. (See p. 20.)

CHAPTER 3

CONCLUSIONS AND RECOMMENDATIONS

CONCLUSIONS

The fund's equipment lease program is an important tool for efficiently and economically acquiring the Government's ADP equipment. The fund's equipment purchases and the use of excess equipment have resulted in significant savings to individual agencies and to the Government. With the expected expansion of the fund, the strengths and weaknesses in its financial management policies will have an ever-increasing impact on individual agencies and the Government as a whole.

The fund's capital has been augmented by capitalizing equipment at values exceeding cost although the Congress intended that the fund would increase its capital by appropriations and transferred equipment. Also, the valuation of purchased equipment in excess of cost is contrary to the accounting principles established for use by Government agencies which prescribe that property should be accounted for at its cost to the agency.

Purchased equipment should be capitalized at cost. Transferred equipment should be capitalized on the basis of objective criteria when cost does not realistically indicate its value.

Charges to user agencies should also be established by objective criteria rather than by negotiations with prospective users. The charges need not be tied to the capitalized value of the individual items but should be designed to approximate the fund's overall costs. These charges should be uniform for similar equipment regardless of whether the equipment has been purchased or transferred. The resulting uniformity should be more acceptable to the agencies and should facilitate management of the equipment lease program, particularly after the anticipated future equipment transfers occur.

On the basis of the fund's experience and available alternatives, charging agencies in advance to provide for anticipated lease termination losses is unnecessary.

The present policies for capitalizing equipment and establishing rents, particularly the negotiation process through which the charges are established, may be increasing administrative costs to GSA and the agencies.

We believe that the agencies' demands for equipment will increase when they become convinced that the equipment is available at the lowest practicable cost. If the demand exceeds the fund's capabilities, it will serve as a basis for seeking additional appropriations from the Congress and will be a persuasive indicator that the fund is a useful tool for achieving savings in acquiring and utilizing ADP equipment.

RECOMMENDATIONS TO THE DIRECTOR, OMB, AND THE ADMINISTRATOR OF GENERAL SERVICES

We recommend that OMB and GSA (1) revise the fund's equipment capitalization policies to insure compliance with Public Law 89-306 and (2) improve the fund's image by revising, to the extent practicable, those policies which the agencies object to. In particular, we recommend that:

--Purchased equipment be capitalized at cost.

--Purchased equipment which has been capitalized at fair market value be revalued at cost and lease agreements be amended to provide for charges based on fund costs.

--Additional income realized from leases of purchased equipment, as a result of lease charges which recover fair market value rather than cost, be transferred to the Treasury in accordance with Public Law 89-306.

--Criteria be established which would facilitate uniform, objective determinations of capitalized values for equipment acquired by transfer from other agencies, when the fund's cost does not realistically indicate the equipment's value.

--Criteria be established which would facilitate uniform, objective determinations of lease charges for identical or similar equipment acquired by purchase or transfer.

--The 10-percent charge for anticipated losses due to early lease terminations be eliminated.

OMB AND GSA COMMENTS AND OUR EVALUATION

The Deputy Director, OMB, and the Acting Administrator of General Services concurred in our recommendations, except as noted below. (See apps. I and II.)

The Acting Administrator did not agree that the existing lease agreements should be amended to provide for charges based on fund costs. He stated that rewriting the leases would be an administrative burden and would produce windfalls to the agencies which had planned, programed, and budgeted funds for the leases. GSA would prefer to continue the leases and deposit the excess income into the Treasury as miscellaneous receipts.

These objections are not persuasive. As of April 1972 only 16 active leases involved purchased equipment that had been capitalized at amounts exceeding costs. Computing the amounts of the reductions in charges that would be applicable to fiscal year 1973 and subsequent periods and obtaining the agencies' concurrence in such amendments to the lease agreements should not require a significant administrative effort. Moreover, the GSA-initiated actions to reduce lease charges would be beneficial in that they would demonstrate to the agencies that GSA is seeking to make equipment available to them at the lowest practicable cost.

The Deputy Director and the Acting Administrator did not agree with our recommendation that the 10-percent charge be discontinued. They believed that losses would occur despite the lease provisions for negotiated settlements and the efforts to find secondary users for the equipment. As an alternative, they proposed that periodic reviews be made to insure that the charge is not unnecessarily high.

Losses generally should not be recognized until the equipment has been disposed of. Instead of collecting in advance for anticipated losses, actual gains or losses determined at the time of disposition can be credited or charged to operations. In accordance with Public Law 89-306, any net income at the end of the year should be transferred to the Treasury as miscellaneous receipts and any net losses should be carried forward to be recovered from future operations.

This accounting treatment, along with the potential for minimizing losses by leasing equipment to secondary users and by negotiating settlements with agencies that terminate their leases, should enable the elimination of the 10-percent charge. Eliminating the charge would improve relationships between the fund and user agencies by demonstrating an intent to make fund equipment available at the lowest practicable cost.

OMB and GSA indicated that they plan to establish comparable rates for all similar equipment. The recovery of losses from future operating income would be consistent with this plan under which the costs and income would be equated in total rather than by individual items.

CHAPTER 4

SCOPE OF REVIEW

Our review was directed toward evaluating the financial management policies of the fund's equipment lease program. We reviewed the legislative history of Public Law 89-306, OMB circulars and guidelines, GSA regulations and procedures, and fund financial reports and records pertaining to the administration of the fund's equipment lease program. We interviewed officials of OMB; GSA; the National Aeronautics and Space Administration; the Departments of Transportation, the Interior, Commerce, the Treasury, the Army, the Navy, and the Air Force; the Defense Supply Agency; the U.S. Postal Service; and the Office of the Secretary of Defense. We made the review at the GSA central office and the headquarters offices of the selected agencies in the Washington, D.C., area.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

JUL 11 1972

Mr. J. K. Fasick
Director, Logistics and
Communications Division
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Fasick:

This letter responds to your request dated June 8, 1972, for comments on a draft GAO report on "Revisions Needed in Financial Management Policies of the Federal Government's Automatic Data Processing Fund."

Revisions to the Office of Management and Budget policy guidelines that were issued to the General Services Administration in May 1968 have been under consideration for some time. Certain of the proposed revisions appeared desirable from a management perspective, but there was some question whether they were consistent with GAO's accounting principles and its views on the legislative intent of P.L. 89-306. Accordingly, we requested GAO's opinions on these proposals on September 27, 1971. In its response dated March 28, 1972, GAO provided useful comments which clarified our respective views. Those comments, together with the views expressed by the draft report, will provide the basis for early issuance of revised policies.

The draft report proposes three recommendations which are acceptable to us:

- Purchased equipment should be capitalized at cost.
- Purchased equipment which has been capitalized at fair market value should be revalued at cost and lease agreements should be amended to provide for charges based on Fund costs.
- The increase in capitalization realized from leases of purchased equipment should be considered as net income and transferred to the U.S. Treasury in accordance with the provisions of P.L. 89-306.

The commentary in the draft report which relates to the above recommendations addresses the general legislative requirement that charges for equipment and services should approximate the Fund's costs. The report states, on page 12, [1]that for the purpose of determining lease charges, OMB can consider equipment costs either collectively or individually. As the number of lease transactions within the Fund increases, and in order to apply a uniform methodology for determining lease charges, it is our intention to view equipment costs on a collective basis. This action will reduce the administrative burden of establishing individual leasing rates and will permit comparable rates to be charged to users for identical or similar equipment regardless of the Fund's costs for any particular piece of equipment or method of acquisition.

In this connection, it should be noted that it is also our intention to charge for the use of equipment for which depreciation costs have been fully recovered, when such equipment is subsequently leased to a new user. Such charges will be based on a fair use value to be determined by the Administrator of GSA at the time of the new lease. This policy is intended to inject a management and cost discipline upon an agency's use of depreciated equipment, and was endorsed by GAO in its letter of March 28, 1972. Since this policy will result in reimbursements in excess of the equipment cost in individual cases, it reinforces the need to view costs on a collective basis in applying the legislative requirement that charges approximate the costs of the Fund. We believe it would be helpful to a general understanding of the legislative intent if some recognition of this point could be included in the report.

The fourth recommendation in the report suggests that the ten percent charge which is included in lease rates to cover possible losses due to early termination of leases be eliminated. GAO considers this charge unnecessary because lease agreements provide for negotiating residual payments to cover any unamortized costs and because GSA may be able to lease the equipment to another user. We cannot concur in this recommendation. Although there may be alternative opportunities available to GSA which could minimize such losses, the fact remains (and the draft report acknowledges) that actual losses could occur because of unsuccessful negotiations or failure to find additional uses for the equipment.

Further, the likelihood of such losses occurring will tend to increase as the activity in the Fund increases. Since it is a common and sound business practice to provide for loss contingencies, we propose to continue the use of a reserve for this purpose. This policy includes a requirement for GSA to review the status of the reserve periodically to determine whether an adjustment to the charges assessed for this purpose is warranted. We would have no objection to a GAO recommendation which called for such a review to be made in light of GAO's belief that the current ten percent charge is unnecessarily high.

The fifth recommendation proposes that a uniform method be established for determining capitalized values and lease charges for equipment acquired by the Fund by transfer from other agencies. We concur in this recommendation and believe it will facilitate the Fund's operations and result in more equitable leasing charges. Although this GAO recommendation (as it applies to leasing charges) is made in the context of transferred equipment, the commentary on page 13 of the report indicates GAO's concurrence in our view, expressed in an earlier paragraph, that a uniform methodology should also be used in determining charges for purchased equipment. It would be helpful if the GAO recommendation were rephrased to clarify this point by embracing purchased as well as transferred equipment.

We appreciate the opportunity to comment on the draft report, and would be pleased to meet with your staff for further discussions if you think this would be desirable.

Sincerely,

Deputy Director

[1] GAO note: These page numbers refer to our draft report.

UNITED STATES OF AMERICA
GENERAL SERVICES ADMINISTRATION
WASHINGTON, DC 20405

JUL 11 1972

Honorable Elmer B. Staats
Comptroller General of the
United States
General Accounting Office
Washington, DC 20548

Dear Mr. Staats:

We have reviewed the draft report on "Revisions Needed in Financial Management Policies of the Federal Government's Automatic Data Processing Fund" which was forwarded to us by Mr. Donald L. Eirich of your office on June 8, 1972. Enclosed are our comments which are identified with the recommendations contained in the subject report.

We appreciate the opportunity to review the contents of the draft report and would be pleased to discuss our comments with your staff if you so desire.

Sincerely,

ARTHUR F. SAMPSON
ACTING ADMINISTRATOR

Enclosure

GSA Comments on GAO Draft Report
"Revisions Needed in Financial Management Policies
of the Federal Government's Automatic Data Processing Fund"

1ST GAO RECOMMENDATION

"Purchased equipment be capitalized at cost".

GSA position: Concur, with the following comments. In valuing ADP equipment included in the equipment lease program of the ADP Fund, GSA has valued it at the fair market value. In most instances, the amount has been in excess of the cost of the equipment. This has been done in accordance with the GSA interpretation of the guidance received from the Office of Management and Budget in a memorandum to the Administrator, GSA, dated May 17, 1968. Section A-2 of this guidance provides in part: "...such equipment shall be capitalized in the Fund at the estimated fair market value as determined by the Administrator...". GSA has assumed that the OMB guidance and the GSA interpretation of that guidance was within the provisions and intent of Public Law 89-306.

2ND GAO RECOMMENDATION

"Purchased equipment which has been capitalized at fair market value be revalued at cost and lease agreements be amended to provide for charges based on Fund costs".

GSA position: GSA concurs in the recommendation that the purchased equipment which has been capitalized at fair market value be revalued at cost. We do not agree, however, that the existing lease agreements should be rewritten in view of the significant administrative burden that would be imposed on GSA as well as the other agencies involved. As these agencies have already planned, programed, and budgeted funds for the existing leases, reductions in those amounts would produce windfalls. We believe the most equitable course of action would be to continue the lease agreements at the existing rates which in view of the revaluation of the ADP equipment and the corresponding lower depreciation charges would provide excess income that would be deposited into the Treasury as miscellaneous receipts.

3RD GAO RECOMMENDATION

"The increase in capitalization realized from leases of purchased equipment be considered as net income and transferred to the U.S. Treasury in accordance with the provisions of Public Law 89-306".

GSA position: Recommend the following change:

"The additional income realized from leases as a result of the increase in capitalization of purchased equipment be considered as net income and transferred to the U.S. Treasury in accordance with the provisions of PL 89-306".

4TH GAO RECOMMENDATION

"The 10 percent charge for possible losses due to early termination of leases be eliminated".

GSA position: Non concur.

Page 40 of Senate Report No. 938 for the 1st Session of the 89th Congress states: "Rates for use of the equipment...are to be fixed by the Administrator so as to approximate the cost charged to the fund, including depreciation and accrued leave... as well as other items of expense recognized and acceptable from the stand point of sound accounting principles".

The draft report on page 16 recognized that some early lease termination losses involving fund expenditures may not be avoidable. The maintenance of an appropriate level of reserves, taking into consideration, the loss experience and the exposure, is in accord with sound accounting principles for preventing such losses from impairing the corpus of the fund. The suggestion on pages 16 and 21 that agencies agree in the leases to negotiate settlement in the event leases are terminated and for that reason, the fund should be able to recover its actual expenditures, has not been the termination experience to date. Normally agencies take the view that the funds available to them at the time of termination are barely sufficient to meet other essential needs involved with the reason for termination. At that time, GSA has been able to negotiate only one or two months continued lease payments or no charge storage by the terminating agency pending removal of the fund property. Some agencies have stated during negotiations that payments to the termination reserve relieves them of all responsibility, but we have interpreted this as only a negotiation posture.

In accordance with OMB guidance, GSA has applied a standard rate of 10% to all leases in the Equipment Lease Program to set up a reserve for the purpose of writing off costs when income is lost as a result of unanticipated lease discontinuance. Procedures have been instituted for the periodic review of the balance of this reserve.

Unfortunately, the loss of income resulting from unanticipated discontinuance of use is not accompanied by a decline in the cost. Equipment depreciation which is by far the largest element of this cost continues through the passage of time regardless of whether the equipment is used or not. Based on the experience to date, we are absolutely certain that there will be losses of income due to unanticipated lease discontinuance. Therefore, we could not agree that GSA should impair the capital of the ADP Fund by not making provision for this.

5TH GAO RECOMMENDATION

"A uniform method for determining capitalized values and lease charges be established for equipment acquired by transfer from other agencies, where cost to the Fund is not a realistic indicator of the equipment value".

GSA position: We concur that a uniform method for determining capitalized values should be established for equipment acquired by transfer from other agencies. For the purpose of determining lease charges, however, we believe, as stated by the draft report at the botton of page 13, that objective criterion should be developed which would result in comparable rates to all users for identical or similar equipment, regardless of whether the Fund acquired the equipment by purchase or transfer. We believe that this objective is in line with the legislative history as indicated in House Report No. 802, 89th Congress, 1st Session, page 30: "In practice, GSA would bill the agencies periodically at rates reflecting the use value of the equipment with the aim that the Fund would break even at the end of each fiscal year".

The format of the draft report on pages 9 through 13 which is presented as Capitalization Policies for Equipment and subdivided in a section on Purchased Equipment and a section on Transferred Equipment also includes in the subsections a discussion on charges (rates); therefore, the position on charges is not clear. For example, the draft report presents, under the Transferred Equipment subsection, a proposed GSA rate solution for both purchased and transferred equipment, but does not clearly accept or reject the GSA position. We believe that the draft report should be clarified to establish a separate basis for capitalization depending on purchase or transfer as a mode of acquisition of the equipment. It should also establish that user rates can be based on fair "use value" irrespective of mode of acquisition by the fund, or of the status of the depreciation reserve for specific equipment.

We have one editorial comment. In the last paragraph, page 5, the word "transferred" should be used in lieu of the word "donated" in order to preserve the actual language of the law and not require new definitions.

PRINCIPAL OFFICIALS OF THE OFFICE OF MANAGEMENT AND BUDGET AND THE GENERAL SERVICES ADMINISTRATION RESPONSIBLE FOR THE ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
OFFICE OF MANAGEMENT AND BUDGET (note a)		
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET:		
Roy L. Ash	Feb. 1973	Present
Caspar W. Weinberger	June 1972	Feb. 1973
George P. Shultz	July 1970	June 1972
DIRECTOR, BUREAU OF THE BUDGET (note a):		
Robert P. Mayo	Jan. 1969	June 1970
Charles J. Zwick	Jan. 1968	Jan. 1969
Charles L. Schultze	June 1965	Jan. 1968
GENERAL SERVICES ADMINISTRATION		
ADMINISTRATOR OF GENERAL SERVICES:		
Authur F. Sampson (acting)	June 1972	Present
Rod Kreger (acting)	Jan. 1972	June 1972
Robert L. Kunzig	Mar. 1969	Jan. 1972
Lawson B. Knott, Jr.	Nov. 1964	Feb. 1969