
BY THE COMPTROLLER GENERAL
 Report To The Chairman,
 Committee On Appropriations,
 House Of Representatives
 OF THE UNITED STATES

**Improper Use Of Industrial Funds By
 Defense Extended The Life Of
 Appropriations Which Otherwise
 Would Have Expired**

By improperly using industrial funds, which are revolving funds modeled after businesslike operations, Defense carried over \$35 million in work from fiscal year 1982 to 1983. This work, financed with Operation and Maintenance funds that otherwise would have expired, extended the 1-year life of those funds. Although this \$35 million in workload carryover at the six industrial fund activities visited is not statistically projectable Defense-wide, GAO believes the matters discussed in this report exist to some degree with other appropriations and at the other 25 Defense industrial fund activities.

GAO recommends that the Department and the Office of Management and Enterprise Affairs enforce controls over the industrial fund process which affects both industrial fund and non-industrial fund activities. Implementing these recommendations should result in (1) proper fiscal year funding of industrial fund activities and (2) more accurate reporting of the results of industrial fund operations.



029033 / 124315

GAO/AFMD-84-34
 JUNE 5, 1984

B-214645

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

Dear Mr. Chairman:

In House Report 97-943 on the fiscal year 1983 Department of Defense appropriation bill, your committee expressed concern that the inherent flexibility in the financing techniques for working capital funds was being used to remove congressional oversight and control over some appropriated funds. Accordingly, the Committee asked us to begin a series of studies of working capital funds in Defense, and set forth several specific issues it wanted addressed. This report responds to the first of the Committee's concerns: whether the life of appropriations was being extended through improper use of Defense working capital funds. Our findings and recommendations are summarized in this letter and discussed in detail in appendix I.

RESULTS OF OUR REVIEW

We found that industrial funds, one of the two basic types of Defense working capital funds, have been improperly used, thereby extending the availability of Operation and Maintenance (O&M) appropriations beyond their 1-year life. As a result, the military services

- used and/or had available fiscal year 1982 O&M funds, which would have otherwise expired, to pay for fiscal year 1983 or later requirements and
- inaccurately reported the true results of industrial fund operations and the status of O&M funds at fiscal year-end.

BACKGROUND AND DESCRIPTION OF WORKING CAPITAL FUNDS

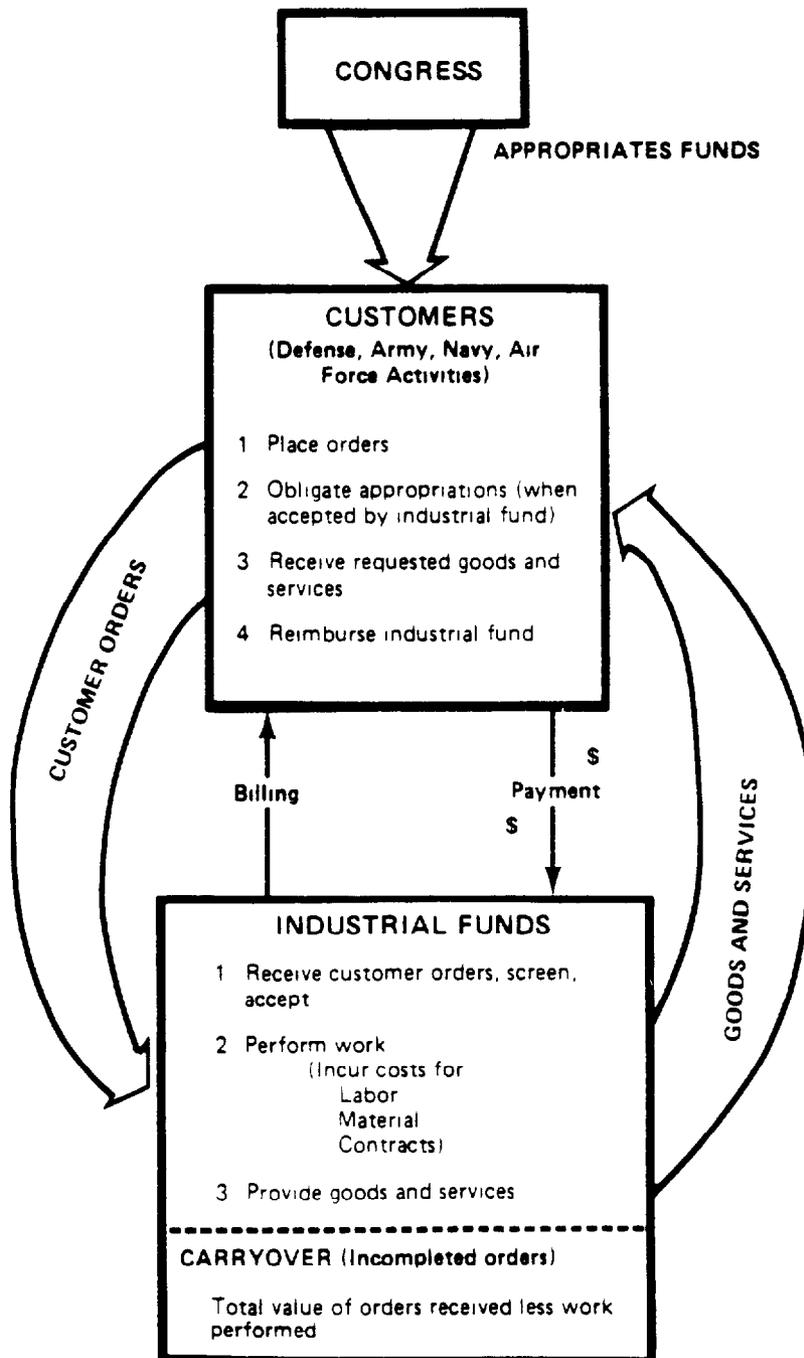
A working capital fund is a revolving fund, operated as an accounting entity, under which assets are capitalized; income from its sale of goods and/or services is used to finance its continuing operations. The two basic types of Defense working capital funds are stock funds and industrial funds. Because of the difference in how the two basic types of working capital funds are operated, we conducted separate reviews of each. The results of our review of Defense stock funds are discussed in our recent report Criteria for Recording Obligations for Defense Stock Fund Purchases Should Be Changed (AFMD-83-54, Aug. 19, 1983). This report discusses the results of our review of Defense industrial fund operations.

Defense industrial funds are modeled after businesslike operations except that as revolving funds they operate on a break-even basis. Industrial funds are designed to (1) provide an effective means for financing, budgeting, accounting for, and controlling costs of producing certain goods and services and (2) create a contractual (buyer-seller) relationship between industrial type activities and customers to provide management advantages and incentives for economy and efficiency. As revolving funds, they should be self-sustaining, that is, industrial fund activities should recover from customers the costs incurred in producing or contracting for goods and services ordered. Defense activities typically financed under industrial funds include Naval shipyards, aircraft repair facilities, and research and development activities. At the time of our review, there were 85 Defense and military service industrial fund activities. These activities sold \$20.4 billion in goods and services during fiscal year 1982.

To facilitate the financial operations of industrial funds, the Congress appropriated limited amounts of working capital. However, most industrial fund budgetary resources (authority to incur obligations) are generated through receipt and acceptance of customer orders. Under the reimbursable process, customer activities use their appropriations, which are generally available for obligation for a limited period of time, to finance orders placed with industrial fund activities. When an industrial fund activity accepts an order, its own budgetary resources are increased and the customer appropriations are obligated by the amount of the order. The industrial fund then uses these budgetary resources to finance obligations incurred to fill customer orders.

The two basic types of orders customers can place with industrial funds are project orders and Economy Act orders. Each type is authorized by a separate statute. Defense regulations specify that project orders, which are issued under the authority in 41 U.S.C. 23, may be used only for certain types of work such as "production or construction, modification, conversion . . .". Generally, routine, recurring, maintenance work (such as real property upkeep) and work needed on a contingency basis (such as emergency repairs) are requested and financed on Economy Act orders, which are issued under the authority in 31 U.S.C. 1535. A major accounting distinction exists between the two types of orders involving how long the related funding is available for use by the industrial fund activity. For example, funds related to O&M funded Economy Act orders which are not used (obligated) by the industrial fund by the end of the fiscal year, are no longer available for new obligations and must be deobligated on customer records. This requirement provides a necessary control over the use of appropriations and related carryover of industrial fund workload between fiscal years. However, to the extent the industrial fund does not accomplish work on project orders by fiscal year-end, unused funds related to the incomplete portion of requested work can be carried over by the industrial fund into the following fiscal year. Such carryover effectively extends the availability of appropriations, which the Congress intended to be limited to 1 fiscal year, into subsequent fiscal years.

While the Congress, the General Accounting Office, and Defense have acknowledged that some carryover is necessary for the continuity of operations, such carryover should be generated only as authorized by existing statutes and regulations governing industrial fund operations. The Committee wanted to know whether working capital funds, in this instance industrial funds, were being improperly used to extend the life of appropriations which would otherwise expire. Therefore, the objective of our review was to determine whether such carryover was generated by the proper use of industrial funds. The reimbursement and carryover process is shown below.



OBJECTIVES, SCOPE, AND METHODOLOGY

In order to determine whether Defense was improperly using industrial funds to extend the life of appropriations which would otherwise expire, we analyzed industrial fund carryover as of the end of fiscal year 1982. We wanted to determine whether the orders financing this carryover had been properly placed by customers and accepted by the industrial fund activities and whether the incomplete portion of the orders should have been carried over between fiscal years according to existing statutes and regulations. To the extent those statutes and regulations had been violated, the carryover extended the availability of appropriations which would otherwise have expired.

We concentrated on the O&M appropriations because those funds were used most frequently to finance orders placed with industrial funds. O&M funded carryover constituted \$3 billion of the \$7.2 billion total Defense industrial fund carryover at the end of fiscal year 1982. Although our findings relate specifically to the O&M funded portion of the carryover at activities we visited, in our opinion they probably also apply, to some degree, to that portion of the carryover funded with other appropriations and at other industrial fund sites.

At the six industrial fund activities visited, we reviewed \$192.5 million of the \$465.2 million in O&M funded carryover as of the end of fiscal year 1982. Our review focused on selected financial issues related to how customer activities finance and account for orders placed with industrial funds and how industrial funds use and account for budgetary resources generated by the acceptance of such orders, especially the amounts carried over between fiscal years. In selected cases, we also reviewed corresponding unliquidated obligations on customer accounting records. Details of our objectives, scope, and methodology are in appendix II.

INDUSTRIAL FUNDS IMPROPERLY
USED RESULT IN THE EXTENSION
OF THE AVAILABILITY OF APPROPRIATIONS

At activities we visited, about \$35.7 million of the \$192.5 million in O&M funded workload we reviewed was carried over from fiscal year 1982 to fiscal year 1983 through improper use of industrial funds. Industrial funds were improperly used because existing laws and the intent of Defense regulations governing industrial fund operations and the use of O&M appropriations were not followed. As a result

- industrial fund and customer activities used and/or had available fiscal year 1982 O&M funds, which would have otherwise expired, to pay for fiscal year 1983 or later requirements and
- industrial fund activities and the military services inaccurately reported the true results of industrial fund operations and the status of service O&M funds at year-end.

To the extent carryover resulting from the improper use of industrial funds is taking place at other Defense activities and with other appropriations, the Congress is not receiving reliable data on which to evaluate the status of those appropriations or the results of industrial fund operations.

Carryover generated by the improper use of the industrial funds we visited was due to a variety of causes. Examples of two of the most prevalent causes are discussed below.

--O&M funded carryover of \$12 million was generated by orders on which the industrial fund activities did not begin work promptly as required by Defense regulations. At activities we visited, orders were not generally reviewed prior to acceptance to determine whether work could be started promptly. For example, in August 1981, the Naval Sea Systems Command issued three project orders totaling \$4.1 million to modify barges located at the Pearl Harbor Naval Shipyard, an industrial fund activity. The three orders, which were financed with fiscal year 1981 O&M funds, were accepted by the shipyard in August 1981. As of March 1983, 20 months after the orders were accepted, the shipyard had not started work on these orders.

Defense and the military services' regulations require that industrial funds start work on an order "within a reasonable amount of time." The Army also requires that evidence must exist of an industrial fund's intent and capability to begin work within 90 days. Defense and the other military services, however, have not specifically defined "reasonable amount of time." Even without specific criteria, many of the instances we found, such as the example discussed above, clearly do not satisfy the Defense requirement for work to be started "within a reasonable amount of time." (See p.4 of app. I.)

--O&M funded carryover of \$20.3 million at the end of fiscal year 1982 at industrial fund activities we visited was generated by orders for goods or services for which customer activities did not have a legitimate current need. For example, a customer activity, the U.S. Army Communications and Electronics Command, issued a project order on the last day of fiscal year 1982, valued at \$744,818 and financed with fiscal year 1982 O&M funds, to the Sacramento Army Depot, an industrial fund activity. The order, which called for maintenance work on 150 preamplifiers, was accepted by the Sacramento Army Depot on the same date and the entire amount of the order was carried over into fiscal year 1983. Our review at the Command, however, showed that all of the requested work was excess to the Command's needs--the entire fiscal year 1982 requirement for such work had already been satisfied. Documentation we reviewed at the Command showed that the Army's item manager for this component also noted in writing that the requested work was excess to needs and should not have been ordered.

Existing statutes and Defense regulations require that annual appropriations, such as O&M, be used only for items which are legitimate needs within the fiscal year for which they are appropriated. To obligate funds, for example, for the purchase of goods or services for which there is no legitimate requirement at the time the purchase is made is improper. In cases where O&M funded carryover resulted from such orders, the 1-year availability of the O&M funds involved was extended.

During our review, Defense activities acted to deobligate the unused O&M funds involved in the examples discussed above. In total, activities we visited deobligated \$8.1 million of the \$35.7 million in carryover we questioned. In responding orally to a draft of this report, Defense officials agreed with \$33.6 million of the \$35.7 million. As discussed on pages 11-13 of appendix I, those officials disagreed with our conclusions on one order containing \$2.1 million of the \$35.7 million in carryover.

CONCLUSIONS

At activities we visited, about \$35.7 million of the \$192.5 million in O&M funded workload we reviewed was carried over from fiscal year 1982 to fiscal year 1983 through improper use of industrial funds. Industrial funds were improperly used because activities did not adhere to existing statutes and regulations governing industrial fund operations and the use of O&M appropriations. This resulted in the extension of the availability of O&M funds which would have otherwise expired. Although the amount of such carryover we found at the six industrial fund activities visited is not statistically projectable departmentwide, we believe the matters discussed in this report may exist to some degree in other appropriations and at the other 79 Defense industrial funds and related customer activities.

Defense and the military services need to strengthen and better enforce existing statutory and regulatory requirements over industrial fund customer orders and industrial fund use of resources related to those orders, especially at fiscal year-end, to ensure that only authorized amounts are carried over between fiscal years.

RECOMMENDATIONS TO THE SECRETARY OF DEFENSE

We are making a series of recommendations to the Secretary of Defense to help prevent the extension of the availability of O&M funds through the improper use of industrial funds. We are recommending that he strengthen controls over:

- the placement of orders with industrial funds,
- industrial fund acceptances of those orders,
- use of and accounting for O&M appropriations, and

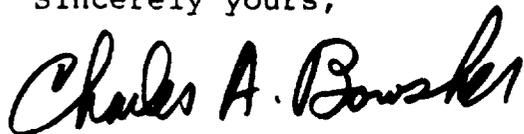
--use of funding authority from orders accepted by industrial funds.

These recommendations, which are on page 12, would require the Secretary of Defense and the Secretary of each military service to better enforce existing regulations and directives, in certain cases providing more detailed criteria, and ensure that the regulations are consistently followed.

In responding orally to a draft of this report, Defense officials concurred with each of our recommendations. Defense's comments were considered in preparing this report and changes were made where appropriate. Defense comments and our evaluation are discussed in detail on pages 12 and 13.

We are sending copies of this report to the Director of the Office of Management and Budget, the Chairmen of the Senate Committee on Appropriations and House and Senate Committees on Armed Services, and the Secretaries of Defense and the military services.

Sincerely yours,

A handwritten signature in black ink that reads "Charles A. Bowsher". The signature is written in a cursive, slightly slanted style.

Comptroller General
of the United States

FINDINGS AND RECOMMENDATIONS ON DEFENSE IMPROPERLY
USING INDUSTRIAL FUNDS RESULTING IN THE EXTENSION OF
THE AVAILABILITY OF OPERATION AND MAINTENANCE APPROPRIATIONS

At the six industrial fund activities visited, we found that about \$35.7 million of the O&M funded carryover from fiscal year 1982 to 1983 was generated by the improper use of industrial funds. Industrial funds were improperly used because existing statutes and regulations governing industrial fund operations and the use of O&M appropriations were not followed. This carryover extended the life of O&M funds which would have otherwise expired. Listed below, for each industrial fund activity visited, is the total amount of O&M funded carryover at the end of fiscal year 1982, the amount of that carryover reviewed by us, and the amount identified as resulting from improper use of industrial funds.

Fiscal Year 1982 O&M Funded Carryover

| <u>Location visited</u> | <u>Total carryover</u> | <u>Carryover reviewed</u> | <u>Carryover resulting from improper use of industrial funds</u> |
|--------------------------------------|------------------------|---------------------------|--|
| | ----- (millions) ----- | | |
| Alameda Naval Air Rework Facility | \$23.3 | \$21.8 | \$3.9 |
| Oklahoma City Air Logistics Center | 266.3 | 100.9 | .7 |
| Pearl Harbor Naval Shipyard | 109.4 | 29.9 | 6.2 |
| Tobyhanna and Sacramento Army Depots | 46.6 | 27.5 | 13.1 |
| San Diego Naval Public Works Center | 19.6 | 12.4 | 11.7 |
| Total | <u>\$465.2</u> | <u>\$192.5</u> | <u>\$ 35.7^a</u> |

^aFigures do not add due to rounding.

The six primary causes and circumstances resulting in the carryover of industrial fund workload at the end of fiscal year 1982, financed with O&M funds which would have otherwise expired, are shown on page 2 and discussed in detail in the following sections.

CAUSES AND AMOUNTS OF O&M FUNDED CARRYOVER
RESULTING FROM IMPROPER USE OF INDUSTRIAL FUNDS

| <u>Causes</u> | <u>Alameda Naval Air Rework Facility</u> | <u>Oklahoma City Air Logistics Center</u> | <u>Pearl Harbor Shipyard</u> | <u>Tobyhanna and Sacramento Army Depots</u> | <u>San Diego Public Works Center</u> | <u>Total</u> |
|--|--|---|---------------------------------------|---|--|--|
| Customers ordered goods and services in excess of requirements | \$1,442,325 | \$741,840 | \$5,811,074 | \$12,314,988 | \$ - | \$20,310,227 |
| Industrial fund activities did not start work on orders within a reasonable amount of time | 354,888 | - | 4,234,532 | 601,121 | 6,761,096 | 11,951,637 |
| Industrial fund activities improperly carried over unobligated funds on Economy Act orders | 1,228,398 | - | 152,810 | - | - | 1,381,103 |
| Industrial fund activities improperly used subsidiary orders | 967,956 | - | 85,772 | - | - | 1,053,728 |
| Customers used expired funds to finance new obligations | - | - | 132,612 | 154,792 | - | 287,404 |
| Industrial fund activities did not perform a substantial amount of work in-house as required | - | - | - | - | 4,980,000 | 4,980,000 |
| TOTAL | <u>\$3,873,504^a</u> | <u>\$741,840</u> | <u>\$6,247,256^a</u> | <u>\$13,070,901</u> | <u>\$11,741,096</u> | <u>\$35,674,597^a</u> |

^a Because some of the carryover we reviewed was improper for more than one of the causes listed, totals shown for the Alameda Naval Air Rework Facility and Pearl Harbor Shipyard as well as cumulative figures for all locations are less than the total of all individual causes.

CUSTOMERS ARE ORDERING GOODS AND SERVICES IN EXCESS OF REQUIREMENTS

Because customers of industrial fund activities improperly placed orders for goods or services in excess of current requirements, or failed to adjust obligations at fiscal year-end to the extent estimated requirements for the year did not materialize, \$20.3 million of fiscal 1982 year-end O&M funded workload was carried over to the following fiscal year, thereby extending the 1-year availability of the O&M funds.

As an annual appropriation, O&M funds are available only to meet legitimate (generally referred to as "bona fide") needs of the fiscal year for which they are appropriated. Current Defense and military service regulations and guidance prescribe requirements related to bona fide need. One area in which customer activities of the industrial fund sites we visited experienced particular problems in satisfying the prescribed bona fide need criteria was where maintenance and repair work was ordered based on estimated requirements. Activities generally obligate O&M funds for such estimated requirements in advance, for example, quarterly. The amount of requirements which actually materialize will usually vary from those estimates. To the extent estimated requirements do not materialize by the end of the fiscal year, there is no bona fide need on the part of the customer. Several activities we visited, however, carried over into the following fiscal year unused amounts, which had been obligated based on estimated requirements which did not materialize. We believe that Defense should inform industrial fund activities and their customers which obligate O&M funds based on estimated requirements to deobligate those funds to the extent that the estimated requirements do not materialize by fiscal year-end.

Listed below are examples in which customers placed orders with industrial funds and recorded obligations based on estimated requirements, and, although those requirements did not fully materialize, the entire unused portion of the order was improperly included in fiscal year 1982 year-end carryover, extending the 1-year availability of those O&M funds.

Sacramento Army Depot

The U.S. Army Communications and Electronics Command issued a project order on May 23, 1982, valued at \$162,200 and financed with fiscal year 1982 O&M funds, to the Sacramento Army Depot for repair work on 14 radio sets. The order was based on the Command's estimated requirements for radio repairs for the remainder of fiscal year 1982. As of September 30, 1982, 10 radio sets had been delivered to the Depot. Because no requirement for repair of the remaining four radio sets materialized by the end of the fiscal year, the funds related to that portion of the order should have been returned and deobligated on customer accounting records. Instead, \$46,343 was carried over to be used by the industrial fund for radio repair work in fiscal year 1983.

In another case, on February 10, 1980, the U.S. Army Communications and Electronics Command issued a \$500,000 project order to the Sacramento Army Depot, citing fiscal year 1980 O&M funds. Although the work was for the repair and return of computer components, the number and identity of specific components or the exact work to be done was not known when the order was placed. The depot received 11 components in fiscal year 1980, 89 more in fiscal year 1981, and 13 in fiscal year 1982. Because the requirement to repair the 102 components received in fiscal years 1981 and 1982 did not exist in fiscal year 1980, the funds related to that portion of the 1980 order should have been returned and deobligated on customer accounting records. We found instead that the Depot carried over the unused funds at the end of fiscal year 1980. The Depot continued to accept and repair components using those funds in fiscal years 1981 and 1982, and at the end of fiscal year 1982, carried over \$185,034 in unused funds into fiscal year 1983 for the then 3-year-old 1980 order.

Oklahoma City Air Logistics Center

A similar problem occurred at the Oklahoma City Air Logistics Center, an Air Force industrial fund activity. We found a total of \$631,845 in fiscal year-end 1982 carryover resulting from estimated asset repair requirements which had not materialized. For example, as of the end of fiscal year 1982, the Air Logistics Center had an open order on hand, part of which was valued at \$131,022 and financed with fiscal year 1982 O&M funds, for the repair of 20 aircraft components. Although none of the components had been transferred into the maintenance activity as of the end of the fiscal year, the \$131,022 was carried over to be used in fiscal year 1983, improperly extending the 1-year life of those 1982 O&M funds.

Air Force officials informed us that, beginning in fiscal year 1983, when funds are obligated in advance based on estimated requirements, those amounts would be deobligated at fiscal year-end to the extent assets to be repaired have not been transferred into the industrial fund activity. This change will provide better administrative control over funds and help ensure that proper fiscal year appropriations are used to fund repair work.

INDUSTRIAL FUND ACTIVITIES ARE NOT BEGINNING WORK ON ORDERS WITHIN A REASONABLE AMOUNT OF TIME

At four industrial fund activities (3 Navy and 1 Army), \$12 million of the O&M funded carryover at the end of fiscal year 1982 was for work which was not started within a reasonable amount of time as required by Defense regulations. As a result the availability of those funds had been extended beyond their normal 1-year life.

Defense regulations (Department of Defense Instruction 7220.1) provide that:

"The work to be performed under project orders shall be expected to commence within a reasonable time

after issue. As a minimum requirement, evidence must exist at the time of acceptance showing the intention that work . . . will begin without delay . . ."

This requirement makes it incumbent upon industrial funds, as a condition of accepting any project order, that they have the intent and the expected capability to begin the requested work without delay. "Reasonable amount of time" for starting work has been defined by the Army as intending to begin work within 90 days (Army Regulation 37-41). We believe that such a period enables activities to carryover ample amounts of work into the following fiscal year to achieve continuity of operations. Although the Air Force has not prescribed a specific period of time, it does provide that assets must be scheduled for input into the industrial fund before funds financing the order expire (Air Force Regulation 170-8). The Navy, however, has not provided guidance on specific time frames or delivery schedules to its industrial fund activities or their customers. In discussing this report with Navy officials, they said that they will consider whether specific time frames could be developed, either Navy-wide or on an industrial fund activity level. We believe that the establishment of specific time frames would provide industrial fund activities better guidelines on the intent of the regulations.

At industrial fund activities we visited, particularly the Navy's, we found that orders were generally not being reviewed prior to acceptance to determine when work could be started. As a result, orders were accepted on which work could not be started promptly, sometimes not for lengthy periods. Without such a review, industrial fund activities accepting the orders could not have established the required intent or verified the expected capability to begin work without delay.

Because the Navy and Air Force had not established specific time frames for starting work, we used the Army's criteria of 90 days in reviewing the start of work on those orders. Some examples of industrial fund activities not initiating work promptly based on this criteria are discussed below.

San Diego Public Works Center

During September 1982, the San Diego Public Works Center accepted 211 project orders containing 345 separate jobs valued at \$7.4 million. This work was to have been performed by the Center's own work force. As shown on the next page, using the Army's criteria of 90 days for work starts, 298 or 87 percent of the jobs (valued at \$6.8 million) were not started on time. Further, as of February 5, 1983, more than 4 months after the orders were placed, 230, or 67 percent, of the jobs still had not been started.

Aging of Jobs from September 1982 Acceptance Date
to Start of Work as of February 5, 1983

| <u>Work started</u> | <u>Number of jobs</u> | <u>Percent of jobs</u> | <u>Value</u> |
|--|---------------------------|--------------------------------|--------------------|
| Within 30 days | 20 | 6 | \$ 254,982 |
| 30 to 60 days | 8 | 2 | 173,711 |
| 61 to 90 days | 19 | 5 | 258,986 |
| 91 to 120 days | 45 | 13 | 487,982 |
| Over 120 days | 23 | 7 | 344,872 |
| Work not started as of Feb. 5, 1983 | <u>230</u> | <u>67</u> | <u>5,928,242</u> |
| Total jobs | <u>345</u> | <u>100</u> | <u>\$7,448,755</u> |

Further, the Navy Facilities Engineering Command has set a target of completing 50 percent of in-house jobs within 93 to 121 days of their acceptance. These targets, however, are also not being met. Our review showed that only 17 percent of all jobs on customer orders accepted in September 1982 were completed within 128 days.

Tobyhanna Army Depot

The U.S. Army Communication and Electronics Command issued a project order to the Tobyhanna Army Depot on September 30, 1982, financed with \$216,869 in fiscal year 1982 O&M funds for maintenance work on two infrared detecting sets needed to support Army avionics maintenance requirements. The order was accepted by the Depot on the same date. Originally, work on the two end items was scheduled to start in October 1982.

During September 1982 (prior to placement of the customer order), because current work in process would not permit start of the work, the two end items were rescheduled for January and February 1983. Under the Army's 90-day criteria, this order should not have been accepted and the obligational authority related to this order should not have been carried over into the following fiscal year.

INDUSTRIAL FUND ACTIVITIES HAVE
IMPROPERLY CARRIED OVER UNOBLIGATED
FUNDS ON ECONOMY ACT ORDERS

Because two of the industrial fund activities did not promptly notify customers of amounts of O&M funds to be deobligated at the end of fiscal year 1982 on the unused (unobligated) balance of

orders placed under the Economy Act, \$1.4 million in O&M funded workload was carried over into fiscal year 1983 and the 1-year availability of those funds was extended.

As discussed on page 2 of the letter, under the Economy Act (31 U.S.C. 1535), to the extent industrial fund activities have not performed requested work or incurred valid obligations before the end of the period of availability of the appropriation funding the customer order, those funds are no longer available to the industrial fund and must be deobligated on customer accounting records. This requirement provides a necessary control over the use of appropriated funds to finance Economy Act orders and the related carry-over of industrial fund workload financed by those funds between fiscal years. Examples where amounts were not deobligated as required follow.

Alameda Naval Air Rework Facility

At the Alameda Naval Air Rework Facility, we identified 29 Economy Act orders, financed with fiscal year 1982 O&M funds, still open as of the end of the fiscal year. These orders were from different customers and involved a variety of types of requested work. We found that at least \$1,228,398 was not yet used by the Air Rework Facility on these orders as of the end of fiscal year 1982. Instead of returning those funds to customer activities for deobligation, however, the Air Rework Facility included the amounts in balances carried over for use in fiscal year 1983. Subsequent to our findings, the Air Rework Facility acted to return almost all of these unused funds to customer activities for deobligation.

Pearl Harbor Naval Shipyard

The Pearl Harbor Naval Shipyard did not notify customers of the amounts of funds related to O&M funded Economy Act orders which were unused as of the end of fiscal year 1982. As a result, customers were not able to promptly deobligate those amounts on their accounting records, as required by law. Instead, the Shipyard carried the amounts over into fiscal year 1983, showing them as still available for use.

Routinely, prior to ordering ship overhaul and repair work, Shipyard customers request advance planning work on Economy Act orders. O&M funds are obligated for such work based on estimates provided by the Shipyard. As specified in the Economy Act, funds on orders for such work are available to the Shipyard only until the end of the fiscal year. At that time, funds not used by the Shipyard must be deobligated on customer accounting records. The customer must rely on the industrial fund activity for information on which to base such deobligations. At the Pearl Harbor Naval Shipyard, we identified nine advance planning Economy Act orders funded with fiscal year 1982 O&M funds for which we estimate there was \$140,000 unused by the Shipyard as of September 30, 1982. The customers should have been notified of these amounts and deobligations of customer funds should have been recorded. Instead, the \$140,000 was carried over, and therefore remained available for use, into fiscal year 1983.

INDUSTRIAL FUND ACTIVITIES ARE
IMPROPERLY USING SUBSIDIARY ORDERS

Because two Navy industrial fund activities improperly used subsidiary orders to other industrial funds, \$1.1 million in fiscal 1982 year-end O&M funded workload was carried over into fiscal year 1983 extending the 1-year life of those O&M funds. These subsidiary orders were improperly used in that they supplanted funding limitations applicable to the original customer orders.

Defense regulations (Department of Defense Instruction 7220.1) provide for the use of subsidiary orders, which are orders placed by one industrial fund activity with another, as long as those orders are "incident to and for use in carrying out the purpose of a customer order." Those regulations also provide that "project orders may not be used for the purpose of extending the availability of appropriations." Current regulations do not, however, specifically address what types of subsidiary orders (that is, project orders or Economy Act orders) can be used in relation to the type of original customer order accepted. In the absence of guidance, industrial fund activities can issue subsidiary orders in either project order or Economy Act order format, to request goods or services originally ordered by customers under either of the same two formats. In any case, however, to comply with the spirit of current Defense regulations, subsidiary orders cannot be used in any manner as a vehicle to extend the availability of funds.

For example, if an industrial fund accepts an O&M funded Economy Act order, to the extent the requested work has not been performed or a contract awarded by the end of the fiscal year, the customer must deobligate the funds. Accordingly, if an industrial fund activity issues a subsidiary order to another industrial fund activity, to the extent the second industrial fund has not incurred obligations for the requested goods or services as of fiscal year-end, those funds are no longer available and must be deobligated by the customer.

Some examples of industrial fund activities improperly using subsidiary orders are discussed below.

Pearl Harbor Naval Shipyard

During fiscal year 1982, the Pearl Harbor Naval Shipyard accepted an O&M funded Economy Act order, valued at \$85,772 and financed with fiscal year 1982 O&M funds, for recurring maintenance work. Prior to the end of fiscal year 1982, the Shipyard, in turn, issued four subsidiary orders, totaling the value of the original order, to the Pearl Harbor Naval Public Works Center (another Navy industrial fund activity) for accomplishing the requested work. We found, however, that the Public Works Center had not started work on any of the orders involved by the end of fiscal year 1982. Under current statutes, therefore, all of the funds for this work should have been returned to and deobligated by the customer at the

end of fiscal year 1982. Instead, they were carried over as available for use in fiscal year 1983, thereby extending the 1-year availability of the O&M funds involved.

Alameda Naval Air Rework Facility

During fiscal year 1982, the Alameda Naval Air Rework Facility accepted an Economy Act order and subsequent amendments with a total value of \$5,567,928, financed with fiscal year 1982 O&M funds, covering various activities including special aircraft rework field teams, aircraft preservations, and training. The Air Rework Facility in turn placed subsidiary orders for some of this work with other industrial funds. As of September 30, 1982, \$645,990 on these subsidiary orders had not been used (obligated) by the performing industrial funds. Rather than returning these funds for deobligation on customer accounting records as required, the Air Rework Facility carried them over into fiscal year 1983, extending the 1-year availability of the O&M funds. For example, on July 19, 1982, the Air Rework Facility issued a subsidiary order to the Public Works Center, valued at \$398,000 for installation of a furnace, one of the items requested under the original customer Economy Act order. The Public Works Center, another industrial fund activity, in turn, planned to let a contract for the requested work, but, as of September 30, 1982, had not done so. Because the Public Works Center did not incur obligations against the subsidiary work order by fiscal year-end, the \$398,000 should have been returned to and deobligated by the customer.

CUSTOMERS ARE USING EXPIRED FUNDS TO FINANCE NEW OBLIGATIONS

At two industrial funds, we identified project order amendments processed in fiscal year 1983, increasing the scope of work to be done on existing project orders which were improperly financed with expired fiscal year 1982 O&M funds. These amendments, totaling \$287,404, extended the 1-year availability of those funds. Fiscal year 1982 O&M funds may be obligated in subsequent fiscal years for additional costs only when the work is within the scope of the fiscal 1982 order and amendments. During the first 4 months of fiscal year 1983, the Pearl Harbor Naval Shipyard received and accepted \$132,612 in customer order amendments citing expired fiscal year 1982 O&M funds, for work which increased the scope of the original orders. For example, the Shipyard accepted an amendment from the Naval Electronics Engineering Activity on October 12, 1982, noting that it was for an increase in work scope. It cited \$43,731 in expired fiscal year 1982 O&M funds. Customer obligations recorded for this amendment were therefore improper and resulted in the availability of those O&M funds being extended beyond their normal 1-year life. Customer officials agreed with us and acted to deobligate the \$132,612 in June 1983.

NAVY PUBLIC WORKS CENTER IMPROPERLY FINANCED
CONTRACT WORK THROUGH INDUSTRIAL FUNDS

The San Diego Navy Public Works Center, contrary to Navy regulations, accepted O&M funded customer orders for work which was to be done on outside contract. Because the Public Works Center did not award those contracts during fiscal year 1982, \$5 million in fiscal year 1982 O&M funds was carried over into fiscal year 1983 extending the 1-year availability of those funds. Those funds would not have been carried over between fiscal years if the Public Works Center had complied with Navy regulations and financed the contracts directly with O&M funds.

Navy regulations (Navy Comptroller Notice 7000 and Instruction 7000.43) provide that work which is going to be done under outside contract be processed under a request for contractual procurement, that is, not financed through industrial fund activities. Contracts are awarded pursuant to such requests for contractual procurement directly citing requestor appropriations. Such work is distinguished from work to be performed internally by an industrial fund, which will generally be requested on a project order. An important difference between the two types of requests is that under a request for contractual procurement, requestor O&M funds expire at the end of the fiscal year if a contract is not let. Under a project order, funds remain available to the industrial fund after the end of the fiscal year.

Navy regulations also require, in accordance with Defense policy, that, as a condition of acceptance of a project order, an industrial fund must be "substantially" in a position to complete the requested work in-house. Navy regulations further stipulate that "substantially" means at least 20 percent of the work being done in-house (Navy Comptroller Manual, volume 5).

At the San Diego Public Works Center, a Navy industrial fund activity, we found that customer activities had submitted, and the industrial fund accepted contrary to Navy regulations, project orders for jobs which were to be done under outside contract. During fiscal year 1982, at the direction of the San Diego Public Works Center, customers submitted project orders requesting a total of about \$5 million in work which was eventually to be performed entirely under outside contracts awarded by the Public Works Center. These jobs were combined on project orders with other jobs which were scheduled to be done in-house by the Center. Combining these dissimilar jobs resulted in each project order, in total, having at least 20 percent in-house work. This practice was contrary to the Navy requirement that jobs to be accomplished under contract be requested under a request for contractual procurement. Since the outside contracts for the requested work were not awarded as of the end of fiscal year 1982, the amounts were carried over into fiscal year 1983, extending the 1-year availability of those O&M funds. The practice also violated the Navy requirement that at least 20 percent of work on any job financed through the industrial fund be accomplished in-house.

For example, the Chief of Naval Education and Training, Pensacola, Florida, issued a project order to the San Diego Public Works Center on September 24, 1982. The Public Works Center Comptroller accepted the order, obligating customer funds on September 28, 1982. The stated purpose of this project order was to provide funds for the Pride and Professionalism Program of the Naval Training Center in San Diego. The project order, valued at \$5 million, and financed with fiscal year 1982 O&M funds, combined 104 different jobs ranging in cost from \$650 to \$220,000. These included 31 jobs, valued at a total of \$2.1 million, which were to be performed by outside contractors. The entire value of this order was carried over into fiscal year 1983 and, as of March 1983, about 6 months after fiscal 1982 year-end, the Public Works Center had not awarded most outside contracts for this work.

In commenting orally on a draft of this report, Defense officials agreed with all our findings regarding the Navy Public Works Center improperly financing contract work through the industrial fund except for the one order discussed above. These officials, while acknowledging that the order comprised 120¹ separate estimates, argued that all work pertained to a specific program, Pride and Professionalism. Consequently, they believe the work was properly requested under one project order and that the 20 percent contracting limitation in Navy regulations applied to the project order as a whole.

We do not agree that the project order for the work to be performed on the Pride and Professionalism Program constituted a single job. In our opinion, the order clearly consisted of 104 separately identifiable jobs requiring individual estimates, 31 of which were to be done entirely under outside contract. Therefore, each of these 104 jobs was subject to the 20 percent contracting limitation. Accordingly, the 31 separate jobs that were to be performed entirely under outside contract, totaling \$2.1 million, should not have been funded through the Industrial Fund. In addition, the entire value of the remaining 73 in-house jobs totaling \$2.9 million, was included in the total amount of work which was not started by the industrial fund (in this case the Public Works Center) within a reasonable amount of time, as shown on p. 2 and discussed on pp. 4-6 of this appendix.

¹At the time of our review, the project order from the Chief of Naval Education and Training consisted of 104 separately identifiable jobs. Subsequently, certain jobs were separated into two or more individual jobs, increasing the total number of jobs on the order to 120 at the time Defense officials orally discussed this matter with our staff.

RECOMMENDATIONS

We recommend that the Secretary of Defense have the Secretaries of the military services emphasize to industrial fund and customer activities the following requirements in Defense and service regulations:

- Project orders are to be placed by customers with industrial funds for only those items for which there is bona fide need at the time of the order.
- Work on orders accepted by industrial funds is to be started within a reasonable amount of time.
- Funds related to O&M funded Economy Act orders which are not used by an industrial fund by the end of the fiscal year are to be promptly deobligated.
- Customer order amendments are to be financed with expired appropriations only when there is no increase in the scope of work to be done.

We also recommend that the Secretary of Defense, in order to facilitate industrial fund and customer activities satisfying these requirements, have the Secretaries of the military services ensure that:

- Officials emphasize to industrial fund activities and their customers, which obligate funds based on estimated requirements, to deobligate those funds to the extent that estimated requirements do not materialize by fiscal year-end.
- When a military service deems it to be appropriate, specific time frames are developed Departmentwide or by type of industrial fund activity, for satisfying the requirement that work be started "within a reasonable amount of time."
- Additional guidance is provided to prohibit industrial fund activities from using subsidiary orders to extend the life of appropriations which would otherwise expire.

Finally, we recommend that the Secretary of Defense have the Secretary of the Navy require that Navy industrial fund and customer activities comply with existing regulations which specifically prohibit (1) combining dissimilar jobs on project orders to meet the requirement that at least 20 percent of requested work be accomplished in-house by the industrial fund and (2) work which will be done entirely on outside contract from being requested on project orders.

DEFENSE COMMENTS AND OUR EVALUATIONS

In responding orally to a draft of this report, defense officials agreed with \$33.6 million of the \$35.7 million in carryover

we questioned. As discussed on page 11 of this appendix, they disagreed with us on one order involving \$2.1 million of that carryover. Other Defense comments on our recommendations and findings and our evaluation of those comments follow.

Although Defense stated that it concurred with the intent of our overall finding regarding the carryover of funds, Defense said that our title and finding present a misleading impression because problems disclosed in the report can only occur at industrial fund activities, when, in fact, reimbursable orders are also used by nonindustrial fund activities.

The title has been changed to indicate that the problems discussed in the report relate specifically to industrial funds. However, Defense's inference that the finding presents a misleading impression because the problems discussed do not relate particularly to industrial funds, but to reimbursable orders in general, is incorrect. First, project orders for the most part are only used in connection with industrial funds. Second, although Economy Act orders can be used to order goods and services from activities other than industrial funds, the report demonstrates how, specifically in the context of the industrial fund process, such orders can be abused to extend the life of the O&M appropriation which would have otherwise expired.

OBJECTIVES, SCOPE, AND METHODOLOGY

In order to determine whether Defense was improperly using industrial funds to extend the life of appropriations which would otherwise expire, we analyzed industrial fund carryover as of the end of fiscal year 1982. We wanted to determine if the amounts were being carried over in violation of existing statutes and regulations. To the extent they were, the carryover extended the availability of appropriations. We concentrated on the O&M appropriations because those funds were used most frequently to finance orders placed with industrial funds.

At the six activities visited, we reviewed \$192.5 million of the \$465.2 million in O&M funded carryover as of the end of fiscal year 1982. Our review focused on selected financial issues related to how customer activities place, finance, and account for orders with industrial funds and how industrial funds use and account for budgetary resources generated by the acceptance of such orders. In selected cases, we also reviewed unliquidated obligations on customer accounting records corresponding to the carryover.

We interviewed cognizant Defense officials and reviewed (1) legislative history, (2) regulations and procedures of Defense and the military services, (3) obligation transactions, and (4) prior audit reports related to industrial fund operations.

Our work was performed primarily at headquarters, Defense, Army, Navy, and Air Force in Washington, D.C., and the following activities:

Navy

Naval Air Rework Facility, Alameda, California
Naval Public Works Center, San Diego, California
Naval Shipyard, Pearl Harbor, Hawaii

Air Force

Air Logistics Center, Oklahoma City, Oklahoma

Army

U.S. Army Depot Systems Command, Chambersburg, Pennsylvania
U.S. Army Communications and Electronics Command,
Ft. Monmouth, New Jersey
Army Depot, Sacramento, California
Army Depot, Tobyhanna, Pennsylvania

Because of the significant differences in the way in which the military services operated their industrial fund activities, and how they accounted for results of industrial fund operations and

carryover at fiscal year-end, we used a variety of methods for reviewing transactions at industrial fund activities visited.

--At Army industrial fund activities (the Sacramento and Tobyhanna Army Depots), we randomly selected and reviewed orders received from the U.S. Army Communications and Electronics Command during fiscal year 1982.

--For the San Diego Navy Public Works Center, we reviewed all customer orders received during September 1982 to determine how quickly work on those orders started. We also reviewed those project orders, open as of the end of fiscal year 1982, containing jobs which were scheduled to be contracted out.

--At the Pearl Harbor Naval Shipyard, we randomly sampled and reviewed project orders open as of the end of fiscal year 1982, and reviewed selected other orders in relation to a variety of other financial issues.

--At the Alameda Naval Air Rework Facility and the Oklahoma City Air Logistics Center (Air Force), we reviewed outstanding orders as of September 30, 1982, based on the largest dollar amounts.

Official comments on a draft of this report were obtained orally from Defense officials. We considered those comments and made changes where appropriate in preparing the report.

The review was made in accordance with generally accepted government auditing standards.

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