United States Government Accountability Office

GAO

Report to the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

July 2008

ARMY WORKING CAPITAL FUND

Actions Needed to Reduce Carryover at Army Depots

GAO-08-714

ARMY WORKING CAPITAL FUND

Actions Needed to Reduce Carryover at Army Depots

G A O
Accountability•Integrity•Reliability
Highlights

Highlights of GAO-08-714, a report to the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

Why GAO Did This Study

The five Army depot maintenance activities support combat readiness by providing services to keep Army units operating worldwide. From fiscal years 2004 through 2007, the amount of new orders received to perform work increased 100 percent from $2.6 billion to $5.2 billion. The number of new orders is a factor in the amount of work the depots carry over from one fiscal year to the next. While past congressional defense committees recognize the need for carryover, the committees have raised concerns that carryover may be more than needed. GAO was asked to determine (1) the growth in reported total carryover from fiscal years 2004 through 2007 and the actions the Army is taking to reduce the carryover, (2) whether reported carryover amounts exceeded carryover ceilings for fiscal years 2006 and 2007 and adjustments made to reduce those amounts, and (3) the primary reasons for the increased carryover at the five Army depots. GAO analyzed reported carryover and related data at the five depots.

What GAO Recommends

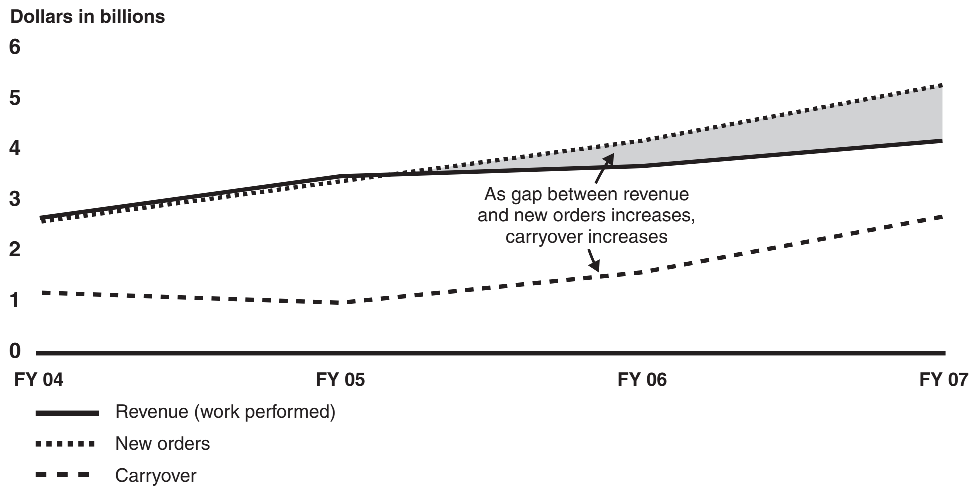
GAO makes eight recommendations to the Department of Defense (DOD) that are aimed at (1) improving the reliability of carryover information and (2) reducing carryover associated with Army depot maintenance activities. DOD concurred with six recommendations and partially concurred with two. DOD commented that it is taking actions on all eight recommendations.

To view the full product, including the scope and methodology, click on GAO-08-714. For more information, contact Paula M. Rascona at (202) 512-9095 or rasconap@gao.gov.

What GAO Found

From fiscal years 2004 through 2007, the Army depots' total carryover significantly increased from $1.1 billion to $2.7 billion—about 7.6 months of work. The amount of carryover increased because new orders received (about $9.5 billion) by the depots significantly outpaced the work performed (about $7.8 billion) in fiscal years 2006 and 2007. GAO analysis of the Army's plan to reduce carryover showed that the depots performed $293 million more work in the first 3 months of fiscal year 2008 than they performed during the same period a year earlier, but the depots missed their planned goal by $173 million.

Analysis of Increases in New Orders and Revenue on Army Depot Maintenance Carryover



Source: GAO analysis of DOD data.

The Army depots reported that they were under the carryover ceiling by $67 million in fiscal year 2006 but over the ceiling by $96.8 million in fiscal year 2007. GAO identified two factors that affected reported carryover amounts. First, the Army Materiel Command directed the Tobyhanna Army Depot to deobligate $30 million at the end of fiscal year 2006 and reobligate the same amount at the beginning of the next fiscal year, which artificially lowered reported carryover and was not in accordance with existing DOD policy. Second, the Army excluded about $299.7 million in fiscal year 2007 orders from the carryover calculations. The exemptions for fourth quarter orders from other services and long lead time material did not provide the right incentives for DOD to resolve long-standing problems.

GAO analysis of reports and discussions with Army officials identified four primary reasons for growth in carryover: (1) the Army depot maintenance budget underestimated the amount of new orders during fiscal years 2006 and 2007 by about $1.7 billion and $1.5 billion, respectively; (2) the depots accepted orders late in the fiscal year that generally could not be completed by the end of the fiscal year; (3) the depots experienced parts shortages; and (4) the depots did not receive assets that had been scheduled for repair.

Contents

Abbreviations

DLA	Defense Logistics Agency
DOD	Department of Defense
HMMWV	High Mobility Multi-Purpose Wheeled Vehicle
OUSD	Office of the Under Secretary of Defense

United States Government Accountability Office
Washington, DC 20548

July 8, 2008

The Honorable Daniel K. Akaka
Chairman
The Honorable John Thune
Ranking Member
Subcommittee on Readiness and Management Support
Committee on Armed Services
United States Senate

The five Army depot maintenance activities[1] support combat readiness by providing services necessary to keep Army units operating worldwide. From fiscal year 2004 through fiscal year 2007, the amount of new orders received to perform work increased from approximately $2.6 billion to $5.2 billion—about a 100 percent increase. These orders were to repair and overhaul a wide range of assets, including helicopters, such as the Apache and Blackhawk; combat vehicles such as the Abrams tank; air defense systems, such as the Patriot missile; electronics; and inventory items for the Army, other military services, and foreign governments. Many of these weapons systems are used to support the Army's current effort in Iraq and Afghanistan. To perform the work needed in support of the Global War on Terrorism, the number of employees at the five depots increased from 12,983 to 15,717—a 21 percent increase—from fiscal year 2004 to fiscal year 2007 and the number of direct labor hours of work increased from about 16.3 million in fiscal year 2004 to 24 million for fiscal year 2007—a 47 percent increase.

The five Army depots operate under the working capital fund concept, where customers are to be charged for the anticipated full cost of goods and services. To the extent that the depots do not complete work at year-end, the funded work will be carried into the next fiscal year. Carryover is the reported dollar value of work that has been ordered and funded (obligated) by customers but not completed by working capital fund activities at the end of the fiscal year. The congressional defense committees recognize that some carryover is needed to ensure a smooth

[1] The five depots are the Tobyhanna Army Depot, Tobyhanna, Pennsylvania; the Letterkenny Army Depot, Chambersburg, Pennsylvania; the Corpus Christi Army Depot, Corpus Christi, Texas; the Anniston Army Depot, Anniston, Alabama; and the Red River Army Depot, Texarkana, Texas.

flow of work during the transition from one fiscal year to the next. However, past congressional defense committee reports raised concerns that the level of carryover may be more than is needed. Excessive amounts of carryover financed with customer appropriations are subject to reductions by the Department of Defense (DOD) and the congressional defense committees during the budget review process. Congress reduced the Army's budgets in fiscal years 2003 and 2006 because of concerns about excess carryover.

As requested and agreed to with your office, our objectives were to determine (1) the growth in reported total carryover from fiscal year 2004 through fiscal year 2007 and the actions the Army is taking to reduce the carryover, (2) whether reported carryover amounts exceeded carryover ceilings[2] for fiscal years 2006 and 2007 and adjustments made to reduce those amounts, and (3) the primary reasons for the increased carryover at the five Army depots. We conducted this performance audit from July 2007 through July 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Most of the financial information in this report was obtained from official Army budget documents and accounting reports. To assess the reliability of the data, we (1) reviewed and analyzed the factors used in calculating carryover, (2) interviewed Army officials knowledgeable about the carryover data, (3) reviewed GAO reports on Army depot maintenance activities, and (4) reviewed orders customers submitted to the depots to determine if they were adequately supported by documentation. Further details on our scope and methodology are provided in appendix I. We requested comments on a draft of this report from the Secretary of Defense or his designee. Written comments from the Under Secretary of Defense (Deputy Comptroller) are reprinted in appendix II.

Results in Brief

Our analysis of Army financial reports showed that the five Army depots' total carryover significantly increased from about $1.1 billion to $2.7 billion (about 7.6 months of work) from fiscal years 2004 through 2007—a

[2] DOD Financial Management Regulation 7000.14-R, vol. 2B, ch. 9, establishes a ceiling for the amount of work that can be carried over from one fiscal year to the next.

$1.6 billion increase. The dollar amount of new orders received in fiscal years 2006 and 2007 by the depots (about $9.5 billion) significantly exceeded the dollar amount of work performed (about $7.8 billion) by the depots during those same years. To reduce the depots' carryover, the Army developed a plan to perform more work in fiscal year 2008. Our analysis of Army documents showed that the Army depots performed $293 million more work in the first 3 months of fiscal year 2008 than they performed during the same period a year earlier, but the work performed was $173 million below the goal set by the Army in its plan. We also found that visibility over these growing carryover balances in the Army Working Capital Fund budgets to Congress was significantly decreased when the Army consolidated the depot maintenance and ordnance activity groups under a single activity group called the Industrial Operations activity group in fiscal year 2005. This reduces the information available to Congress for making informed decisions about the appropriate size of the Army depot maintenance budget and whether or not the depots are making significant progress in reducing their carryover.

In fiscal year 2006, the Army depot maintenance activities' reported that carryover was under the carryover ceiling by $67 million. A factor that reduced the reported carryover in fiscal year 2006 was that the Army Materiel Command directed the Tobyhanna Army Depot (Tobyhanna) to deobligate orders totaling $30 million at year-end and then reobligate these funds at the beginning of the next fiscal year. This action served to artificially lower reported carryover. As we have previously reported,[3] the reliability of carryover data and their usefulness as a management tool are significantly reduced by the manipulation of customer order balances in an attempt to reduce reported carryover amounts. For fiscal year 2007, the depots exceeded the carryover ceiling by $96.8 million. However, the Office of the Under Secretary of Defense (OUSD) (Comptroller) approved about $299.7 million in carryover exemptions from the carryover calculations for the five Army depots that were not excluded in previous years. DOD's actions to grant these exemptions for (1) fourth quarter orders from other services and (2) long lead time material did not provide the right incentives for DOD components to resolve long-standing

[3] GAO, *Navy Working Capital Fund: Backlog of Funded Work at the Space and Naval Warfare Systems Command Was Consistently Understated*, GAO-03-668 (Washington, D.C.: July 1, 2003) and GAO, *Navy Working Capital Fund: Management Action Needed to Improve Reliability of the Naval Air Warfare Center's Reported Carryover Amounts*, GAO-07-643 (Washington, D.C.: June 26, 2007).

problems. Without the exemptions, the depots would have exceeded the fiscal year 2007 carryover ceiling by $251.2 million.

Our analysis of fiscal years 2006 and 2007 Army depot reports and discussions with depot officials identified four primary reasons for the significant growth in carryover. While some of these reasons are under the control of other DOD activities, such as customers not sending assets needing repair to the depots as planned, other reasons are within the depots' control.

- First, the Army depot maintenance budget significantly underestimated the amount of new orders received from customers by about $1.7 billion and $1.5 billion for fiscal years 2006 and 2007, respectively. While the depots performed more work than budgeted during fiscal years 2006 and 2007, they could not keep pace with the increases in new orders.
- Second, the depots accepted new orders late in fiscal years 2006 and 2007 that could not reasonably be completed (and in some cases were not even started) prior to the end of the fiscal year.
- Third, our analysis of depot data and interviews with depot officials found that the depots experienced shortages in parts needed to perform their work in fiscal years 2006 and 2007.
- Fourth, based on our review of selected depot production reports on the status of work and discussions with depot officials, we determined that unserviceable assets (assets requiring repair) were not sent to the depots for repair as planned. Army officials informed us that in some cases the assets remained in-theatre (such as Iraq) for longer periods than planned.

We are making eight recommendations to DOD to (1) improve the reliability of the carryover amounts reported to Congress and DOD decision makers and (2) reduce carryover associated with the Army depot maintenance working capital fund activities. DOD concurred with six of the eight recommendations and partially concurred with the other two recommendations. While DOD partially concurred with two recommendations, DOD cited actions under way, or planned, with respect to all eight recommendations.

Background

A working capital fund relies on sales revenue rather than direct appropriations to finance its continuing operations. A working capital fund is intended to (1) generate sufficient resources to cover the full costs of its operations and (2) operate on a break-even basis over time—that is, neither make a gain nor incur a loss. Customers use appropriated funds, primarily operations and maintenance appropriations, to finance orders placed with the working capital fund. According to the Army's fiscal year 2008/2009 budget, the Army Working Capital Fund will earn about $15.3 billion in revenue during fiscal year 2008. The Army Working Capital Fund includes an industrial operations activity group that provides the Army with the in-house industrial capability to conduct depot-level maintenance, repair, and upgrade; produce quality munitions and large- caliber weapons; and store, maintain, and demilitarize material for all branches of DOD. For example, the Anniston Army Depot (Anniston) repairs tanks for the Marine Corps. The industrial operations activity group consists of 13 activities—five maintenance depots, three arsenals, two munitions production facilities, and three storage sites. The preponderance of the industrial operations workload and budget estimates relate to the depot-level maintenance work. Information on the five Army depots follows.

- Anniston performs maintenance on both heavy- and light-tracked combat vehicles and their components, such as the M1 Abrams tank.
- Corpus Christi Army Depot (Corpus Christi) overhauls, repairs, modifies, tests, and modernizes helicopters, engines, and components for all services and foreign military customers.
- Letterkenny Army Depot (Letterkenny) has tactical missile repair capabilities supporting a variety of DOD missile systems including the Patriot and its ground support and radar equipment. In response to the Global War on Terrorism, Letterkenny is rebuilding the High Mobility Multi-Purpose Wheeled Vehicles (HMMWV) that are returning from theater and is rebuilding them to a configuration that will support add-on armor.
- Red River Army Depot (Red River) performs maintenance, certification, and related support services on ground combat systems, air defense systems, and tactical wheeled vehicles. Systems supported include the Bradley Infantry Fighting Vehicle, Multiple Launch Rocket System, Small Emplacement Excavator, 5-ton dump truck, and HMMWVs.
- Tobyhanna uses advanced technologies to ensure the readiness of U.S. armed forces and is a full-service repair, overhaul, and fabrication facility for communications-electronics systems, and equipment and select missile guidance systems.

Carryover is the reported dollar value of work that has been ordered and funded (obligated) by customers but not completed by working capital fund activities at the end of the fiscal year. Carryover consists of both the unfinished portion of work started but not completed, as well as requested work that has not yet begun. Some carryover is necessary at the end of the fiscal year if working capital funds are to operate efficiently and effectively. For example, if customers do not receive new appropriations at the beginning of the fiscal year, carryover is necessary to ensure that the working capital fund activities have enough work to ensure a smooth transition between fiscal years. Too little carryover could result in some personnel not having work to perform at the beginning of the fiscal year. On the other hand, too much carryover could result in an activity group receiving funds from customers in one fiscal year but not performing the work until well into the next fiscal year or subsequent years. By optimizing the amount of carryover, DOD can use its resources in the most effective manner and minimize the "banking" of funds for work and programs to be performed in subsequent years.

In 1996, DOD established a 3-month carryover standard for working capital fund activities. In May 2001, we reported[4] that DOD did not have a basis for its carryover standard and recommended that DOD determine the appropriate carryover standard for depot maintenance, ordnance, and research and development activity groups. DOD included its revised carryover policy in DOD Financial Management Regulation 7000.14-R, volume 2B, chapter 9. Under the new policy, the allowable amount of carryover is based on the outlay rate[5] of the customers' appropriations financing the work. According to the DOD regulation, this carryover metric allows for an analytical-based approach that holds working capital fund activities to the same standard as general fund execution and allows for meaningful budget execution analysis.

In accordance with DOD policy, (1) nonfederal orders, (2) non-DOD orders, (3) foreign military sales, and (4) work related to base realignment and closure are excluded from the carryover calculation. Further, the Army has requested and OUSD (Comptroller) has approved an exemption of crash and battle damaged aircraft from the carryover ceilings during wartime operations for the past few years. This has resulted in tens of millions of dollars of orders and carryover being excluded from the

[4] GAO, *Defense Working Capital Fund: Improvements Needed for Managing the Backlog of Funded Work*, GAO-01-559 (Washington, D.C.: May 30, 2001).

[5] The amount of allowable carryover using the outlay rate is shown in the following example. Customers order $100 of work, which is financed with a specific appropriation. If the outlay rate for this appropriation at the appropriation level is 60 percent, then this would result in the working capital fund activity group being allowed to carry over $40 ($100 - $60 [$100 x 60 percent] = $40).

carryover calculation. The reported actual carryover (net of exclusions) is then compared to the amount of allowable carryover using the above-described outlay rate method to determine if the reported actual amount is over or under the allowable carryover amount.

In 2005, we reported[6] that the Army depot maintenance activities consistently exceeded the carryover ceiling from fiscal years 1996 through 2003. Tables 1 and 2 show that the Army depot maintenance activities' actual reported carryover (1) consistently exceeded DOD's 3-month carryover standard from fiscal year 1996 through fiscal year 2001 and (2) continued to exceed the allowable amount of carryover as calculated under DOD's revised carryover policy for fiscal years 2002 and 2003.

Table 1: Fiscal Year-end Actual Reported Carryover from Fiscal Year 1996 through 2001 Consistently Exceeded DOD's 3-Month Standard

Fiscal year	Reported actual months of carryover
1996	3.6
1997	3.2
1998	3.4
1999	4.4
2000	4.2
2001	3.4

Source: Army Working Capital Fund budgets.

Table 2: Dollar Amounts of Reported Actual Carryover for Fiscal Years 2002 and 2003 Exceeded Allowable Amounts

Dollars in millions		
	Fiscal year 2002	**Fiscal year 2003**
Allowable carryover	$548.2	$854.4
Reported actual carryover	584.3	981.5
Carryover above allowable amount	$36.1	$127.1

Source: Army Working Capital Fund budgets.

[6] GAO, *Army Depot Maintenance: Ineffective Oversight of Depot Maintenance Operations and System Implementation Efforts*, GAO-05-441 (Washington, D.C.: June 30, 2005).

Decision makers, including OUSD (Comptroller) and congressional defense committees, use reported carryover information to make decisions concerning whether working capital fund activities, such as the Army depots, have too much carryover. If the Army depots have too much carryover, the decision makers may reduce the customers' budgets and use these resources for other purposes. For example, Congress has reduced the services' budgets because of excessive carryover, including a reduction in the Army's fiscal years 2003 and 2006 operation and maintenance appropriations by $48 million and $94.7 million, respectively.

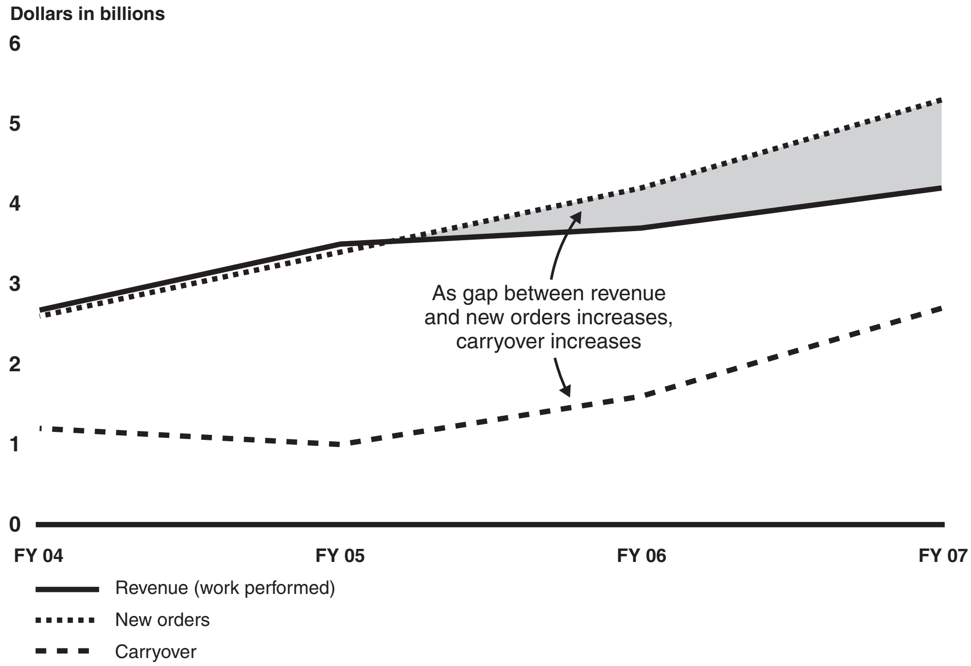
Army Depots' Carryover Significantly Increased

The Army depots' total carryover significantly increased from $1.1 billion in fiscal year 2004 to $2.7 billion in fiscal year 2007—a $1.6 billion increase. In order to reduce the fiscal year 2007 carryover, the Army developed a plan to perform $5.5 billion of work in fiscal year 2008—$1.4 billion more than the Army depots performed in fiscal year 2007. Our analysis of the plan and first quarter fiscal years 2007 and 2008 execution data show that the depots performed significantly more work than they performed during the same period in the prior year but the depots missed their goal by $173 million at the end of December 2007. Further, while the Army depot maintenance carryover amount had more than doubled over the past 4 years, this increase has not been specifically identified in the Army Working Capital Fund budgets to Congress because the Army consolidated the depot maintenance and ordnance activity groups under a single activity group called the Industrial Operations activity group in fiscal year 2005.

Army Depots' Carryover Significantly Increased in Fiscal Years 2006 and 2007

From fiscal years 2004 through 2007, the Army depots' total carryover significantly increased from $1.1 billion to $2.7 billion. The dollar amount of new orders received in fiscal years 2006 and 2007 (about $9.5 billion) by the depots significantly exceeded the dollar amount of work performed (about $7.8 billion) by the depots during those same years. The depots carried over about 7.6 months of work into fiscal year 2008. Figure 1 illustrates how changes in fiscal years 2004 through 2007 new orders and work performed (revenue) have affected depot carryover.

Figure 1: Analysis of Increases in New Orders and Revenue on Army Depot Maintenance Carryover



Source: GAO analysis of DOD data.

As shown in figure 1, the new orders and work performed (revenue) increased from fiscal year 2004 through fiscal year 2007. However, the dollar amount of new orders increased at a greater pace than the dollar amount of work performed (revenue). New orders increased from about $2.6 billion to about $5.2 billion (about 100 percent increase) while the amount of revenue earned increased from $2.7 billion to about $4.2 billion (56 percent increase).

Army Developed a Plan in Fiscal Year 2008 to Reduce Carryover

In the first quarter of fiscal year 2008, the Army developed a plan to reduce the level of carryover at the Army depots. According to the plan, the Army depots would perform $5.5 billion of work in fiscal year 2008—$1.4 billion more than the Army depots performed in fiscal year 2007. In order to meet the revenue increases, the depots plan to take a number of actions, including hiring additional maintenance personnel and requiring maintenance personnel to work overtime. Our analysis of the five Army depots' revenue for the first quarter of fiscal years 2007 and 2008 showed that the depots increased their revenue by about $293 million in the first quarter of fiscal year 2008 (about $1.1 billion) compared to the same quarter the prior year ($817 million). Even though the depots increased their revenue, the depots missed their fiscal year 2008 first quarter revenue targets by about $173 million ($1.282 billion target less $1.109 billion actual revenue). By missing the first quarter target, the Army is at risk of not meeting the carryover reduction plan goals for fiscal year 2008.

In January and February 2008, we met with officials at the five Army depots to determine why some of the depots missed their revenue targets for the first quarter of fiscal year 2008. For the depots that missed their revenue targets, the officials stated that (1) the depots performed a different mix of workload than originally planned, generating less revenue; (2) unserviceable assets did not arrive as planned and the depots could not perform the planned workload; and (3) spare parts were not available to perform the planned workload. Even though several of the depots missed their first quarter revenue targets, officials at all but one of the depots—Anniston—stated that they expected to meet their end of fiscal year 2008 revenue targets. Anniston officials stated that they believed they would miss their revenue target by about $200 million, but they were attempting to identify additional work they could perform to increase revenue in fiscal year 2008. While officials at four of the five depots believed that they would meet their revenue targets and thus reduce carryover by the end of fiscal year 2008, the reduction of the carryover amount will largely depend on the amount of new orders accepted by the depots in fiscal year 2008 and the ability of the depots to perform their fiscal year 2008 workloads as planned.

Army Depot Maintenance Activities' Carryover Is Not Separately Identified in Budgets to Congress

Although the Army depot maintenance carryover amount had more than doubled over the past 4 years, this increase in Army depot maintenance activities' carryover amount has not been specifically identified in the Army's Working Capital Fund budgets to Congress because the Army consolidated the depot maintenance and ordnance activity groups under a single activity group called the Industrial Operations activity group in fiscal year 2005. Prior to the consolidation, the Army Working Capital Fund budgets provided carryover information, such as the dollar amount of carryover and the carryover ceiling for the depot maintenance activities. Without detailed data on the Army depot maintenance activity groups' carryover, Congress cannot make informed decisions about the appropriate size of the Army depot maintenance budget and whether the depots are making significant progress in reducing their carryover amounts. In light of the significant increase in new orders and carryover at the Army depots because of ongoing wartime operations, it is even more important for the Army to report carryover information to Congress separately to provide visibility of the Army depot maintenance activities.

Reported Carryover Amounts for Fiscal Years 2006 and 2007 Were Artificially Lowered

Reported Army depot maintenance activities' carryover was reduced by tens of million of dollars by (1) funds being deobligated at the end of fiscal year 2006 and then reobligated in the beginning of fiscal year 2007 and (2) amounts that were exempted from carryover calculations in fiscal year 2007. The deobligations of funds at the end of fiscal year 2006 and the fiscal year 2007 exemptions affected the amount of reported carryover as well as the amount of carryover that was over/under the carryover ceiling for fiscal years 2006 and 2007.

Deobligating Selected Orders Reduced Reported Carryover Amounts for Fiscal Year 2006

In fiscal year 2006, the Army depot maintenance activities reported that carryover work and related funding was under the ceiling by $67 million. In order to reduce the Army's Industrial Operations fiscal year 2006 carryover, the Army Materiel Command directed Army activities to deobligate selected procurement-funded orders totaling $83 million. Specifically, Tobyhanna was directed to deobligate $30 million, and an Army ordnance activity (Pine Bluff Arsenal) was directed to deobligate $53 million by September 29, 2006, for work that they still planned to perform. The guidance stated that the orders would be reobligated on October 2, 2006. Further, the guidance stated that (1) the Industrial Operations carryover estimate increased by $388 million since the summer budget submission to OUSD (Comptroller) and (2) the Army did not want to exceed its carryover ceiling and give OUSD (Comptroller) "an excuse to doubt our ability to execute the fiscal year 2007 or fiscal year 2008 supplemental funding." Our review of Tobyhanna records showed that customers deobligated $30 million against six orders on September 28 and September 29, 2006. The funds were then reobligated within the next 2 weeks.[7]

The action directed by the Army Materiel Command artificially lowered the reported carryover balances for Army's Industrial Operations and more specifically the Army depot maintenance activities in fiscal year 2006. As discussed previously, congressional decision makers receive an aggregated report on carryover balances that covers the Army's Industrial

[7] The 3-year procurement funds had not expired when they were reobligated.

Operations activities. We have previously reported[8] on a similar year-end deobligation problem related to Navy research and development activities. In response to our recommendation on this issue, OUSD (Comptroller) issued guidance on July 28, 2003, to the military services and DOD components prohibiting the manipulation of customer order balances in an attempt to reduce reported carryover. The guidance directed components to conduct internal reviews of accounting procedures currently in use, to include year-end adjustments, to ensure that this type of manipulation of carryover levels is not occurring.

Exemptions Reduced Reported Carryover Amounts for Fiscal Year 2007

For fiscal year 2007, OUSD (Comptroller) approved about $299.7 million in additional exemptions from the carryover calculations that were not excluded in previous years. Without the exemptions, the depots would have exceeded the carryover ceiling by $251.2 million. However, with the exemptions, the depots exceeded the carryover ceiling by $96.8 million. These exemptions were for (1) a public-private partnership involving Anniston ($194.2 million); (2) fourth quarter orders received by Anniston, Corpus Christi, and Tobyhanna from other services ($77.4 million); and (3) long lead time material at Anniston ($28.1 million). In discussing the exemptions with OUSD (Comptroller) officials, the officials stated that they approved all carryover exemptions requested by the depots for orders received from other services in the fourth quarter of fiscal year 2007 and the public-private partnership arrangement involving Anniston. The officials stated that they denied some of the depots' carryover exemption requests for long lead time material. Further, the officials stated that the exemption requests that were granted for fiscal year 2007 carryover and their associated new orders resulted from the large increase in supplemental funding provided to the depots in support of ongoing wartime operations. The officials stated that the Army would have to request the exemptions next year if similar circumstances exist.

Based on our review of the Army's exemption request and our findings in prior reports,[9] as well as discussions with OUSD (Comptroller) and Army officials, we found that these exemptions do not provide the right incentives to the depots, customers, Defense Logistics Agency (DLA), and Army Supply to correct long-standing problems with receiving orders from other services late in the fiscal year and program delays caused by long

[8] GAO-03-668 and GAO-07-643.

[9] GAO-01-559 and GAO-05-441.

lead time material. Because these issues are exempted, they are not subject to the level of scrutiny and possible corrective actions that would be provided if these problem areas were reflected in higher reported carryover balances. We reported in May 2001 and again in June 2005 that Army depots exceeded their carryover ceiling because some depots received and accepted work late in the fiscal year, and some depots could not obtain the material needed in a timely manner so that less work was performed than planned. As discussed in the next section, our current review found similar problems with late year orders and the lack of spare parts available for repair.

Four Primary Reasons for Significant Growth in Fiscal Years 2006 and 2007 Carryover

Our analysis of depot reports and discussions with Army officials identified four primary reasons for the growth in carryover. First, during fiscal years 2006 and 2007, the Army depot maintenance budget significantly underestimated the amount of new orders actually received from customers. While the depots performed more work than budgeted, they could not keep pace with the increases in new orders. Second, we found that the depots accepted orders late in the fiscal year that reasonably could not be completed, and in some cases could not even be started, prior to the end of the fiscal year. Third, we found that parts shortages prevented work from being performed. Fourth, unserviceable assets (assets that need to be repaired) scheduled for repair did not arrive at the depots as planned. While some of these reasons are under the control of other DOD activities, such as customers not sending assets needing repair to the depots as planned, other reasons are within the depots' control.

Army's Budget Underestimated Significant Growth in New Orders

For fiscal years 2006 and 2007, the Army depot maintenance budget significantly underestimated the amount of new orders actually received from customers by about \$1.7 billion and \$1.5 billion, respectively. For example, while the budget shows that the depots expected to receive about \$3.7 billion in new orders and perform about \$3.8 billion of work (revenue) in fiscal year 2007, the depots actually received about \$5.2 billion in new orders and performed \$4.2 billion of work. To perform more work during fiscal year 2007, the depots increased the number of employees and the direct labor hours performed by 630 employees and about 2.8 million direct labor hours over their fiscal year 2006 totals. However, while the work performed by the depots (revenue) increased from fiscal year 2006 to fiscal year 2007, it did not increase at the pace of the orders received from customers, resulting in the large growth of carryover.

Our analysis of the Army budget guidance for fiscal year 2006 showed that the Army assumed that the fiscal year 2006 new orders would amount to approximately 50 percent of the fiscal year 2005 operation and maintenance budget, Army supplemental workload. For fiscal year 2007, the Army assumed that the fiscal year 2007 orders would be approximately 25 percent less than the fiscal year 2006 program. These budget assumptions resulted in the reported actual orders significantly exceeding budgeted orders for fiscal years 2006 and 2007. For example, at Anniston, our analysis showed that the depot originally budgeted to receive about $1.1 billion of new orders for fiscal year 2007. During the midyear review in March 2007, Anniston revised its estimate to about $1.4 billion. However, the depot actually received about $1.5 billion of new orders for fiscal year 2007—a difference of about $400 million or 36 percent from the original amount budgeted.

In discussing this matter with Army headquarters officials, they told us that budgeting for new orders was affected by the continuing Global War on Terrorism and the anticipated supplemental appropriations to finance the war. Army headquarters officials said that the Army underestimated the amount of new orders received by the depots because (1) the Army did not have any historical information on the amount of funds the depots would receive in the supplemental appropriations for depot maintenance work and (2) of the uncertainty related to the amount of funds the Army would receive in the supplemental appropriations for this depot maintenance work. Without reliable budget estimates, the Army depots cannot make the necessary adjustments to their manpower and material to ensure that the depots can meet the Army's maintenance requirements.

Carryover Increased Because of Army Depots Receiving Orders Late in the Fiscal Year

In June 2006, we reported[10] that carryover is greatly affected by orders accepted late in the fiscal year that generally cannot be completed, and in some cases cannot even be started, prior to the end of the fiscal year. As a result, almost all orders accepted late in the fiscal year increase the amount of carryover. DOD Financial Management Regulation 7000.14-R, volume 11A, chapters 2 and 3, prescribes regulations governing the use of orders placed with working capital fund activities. The DOD regulation identifies a number of requirements before a working capital fund activity accepts an order. For example, work to be performed under the order

[10] GAO, *Defense Working Capital Fund: Military Services Did Not Calculate and Report Carryover Amounts Correctly,* GAO-06-530 (Washington D.C.: June 27, 2006).

shall be expected to begin within a reasonable amount of time after the order is accepted by the performing DOD activity. As a minimum requirement, it should be documented that when an order is accepted, the work is expected to (1) begin without delay (usually within 90 days) and (2) be completed within the normal production period for the specific work ordered. Our analysis of fiscal years 2006 and 2007 orders showed that orders received in the fourth quarter continued to be a problem. For example, two of the five depots accepted more than 20 percent of their new fiscal year 2006 orders in the last 3 months of the fiscal year. The following examples illustrate orders that were accepted by Army depot maintenance activities late in fiscal year 2006.

- In September 2006, Tobyhanna accepted an order from Tinker Air Force Base totaling approximately $3.3 million financed with operation and maintenance funds that would expire on September 30, 2006. The order was for the overhaul of an Air Force landing control radar that was located at Ramstein Air Base, Germany. According to an Air Force official and documentation, the Air Force identified the maintenance requirement in March 2006; however, funds were not made available until the end of fiscal year 2006, when additional funds were identified from other programs. As a result, the depot carried over the entire $3.3 million into fiscal year 2007. In addition, depot officials stated that the depot experienced several delays in performing the work on the radar because of the initial unavailability of the asset (2-month delay), reconfiguration and resheltering of the asset, and the unavailability of long lead time parts. Because of these problems, the depot carried over approximately $1.8 million from fiscal year 2007 into fiscal year 2008 and expects to complete the overhaul of the landing control radar on January 30, 2009.

- In August 2006, Letterkenny accepted an order totaling about $8.4 million that was financed with operation and maintenance funds for the repair of 15 Patriot launching stations. According to the production controller, the initial inspection and teardown work on the Patriot launching stations began when the order was accepted. Since repair work on the Patriot launching stations did not begin until August 2006, about $7.1 million of funded workload was carried over into fiscal year 2007. According to the production controller, if the repair work for the Patriot launching stations was funded earlier in the fiscal year, then the carryover amount would have been a lot lower. All of the repair work for the 15 Patriot launching stations was completed by February 2007.

Depots Could Not Obtain Parts Needed to Perform Repair Work as Scheduled

Our analysis of depot data and interviews with depot officials found that the depots experienced shortages of parts needed to perform their repair work in fiscal years 2006 and 2007. Our analysis of data in the critical maintenance repair parts reactive system[11] at four depots showed that in 733 and 605 instances, repair parts shortages resulted in work stoppage in fiscal years 2006 and 2007, respectively. DLA and to a lesser extent Army Supply were the sources of supply for most of the repair parts. DLA officials told us that a major difficulty DLA faces as a supplier is forecasting the amount of repair parts needed when the depots' types and numbers of repairs keep changing. Having a firm requirement (quantity of items to be repaired) early in the process is critical if DLA is to provide the spare parts to the depots when they need them. However, this has not always been the case. For example, as discussed later in this report, in November 2006, Red River accepted an order to overhaul 200 HMMWVs. Over the next 4 months, the order was amended first to decrease the quantity to 106 and then increase the quantity to 344. According to DLA officials, changing requirements, similar to this example, make it extremely difficult to forecast the spare parts needed for repairs. If DLA waits to buy the parts until the depot has a firm requirement, the parts might not be available when the depot needs them. On the other hand, if DLA buys the parts before the requirement is firm, DLA is at risk for excess inventory of parts when requirements for parts are significantly reduced.

In order to perform the required repair work and help minimize the impact of parts shortages on depot operations, the depots have taken a number of actions to obtain parts when they were not available, including using parts from other assets, commonly referred to as robbing parts; fabricating the parts; and obtaining parts through the use of their local procurement authority, including the government purchase card. The following are examples of actions taken by the depots.

- In October 2006, Anniston accepted a $5.6 million order financed with fiscal year 2007 operation and maintenance appropriated funds to overhaul 1,200 M2 machine guns. The work was originally scheduled to begin in March 2007. Because of the lack of parts, the work did not begin until July 2007 which resulted in more carryover than originally

[11] The critical maintenance repair parts reactive system provides data on parts shortages or potential parts shortages that have or will cause the depots to resort to "work-around" methods to try to prevent work stoppages.

planned. About $5.4 million of the $5.6 million carried over from fiscal year 2007 into fiscal year 2008.

Because of the Global War on Terrorism and the surge in production of the M2s, Anniston had problems with obtaining parts to overhaul the machine guns since 2004. Because the depot could not get the needed parts from DLA or Army Supply, it used parts from other M2 machine guns. Some of these parts included the barrels, buffer body assemble, bolt, barrel extensions, breech locks, and receivers. Since the depot used parts from these 1,200 machine guns to repair machine guns in previous years, these 1,200 machine guns were missing parts. By the time the depot overhauled the 1,200 M2 machine guns, about half of the M2s had been totally stripped of their parts. An Army official stated that the machine guns going through overhaul were the "worst of the worst." To perform the work, the depot had to buy new parts and have the Picatinny Arsenal fabricate barrel extensions in order to obtain the parts needed to complete the overhaul. This extra work increased the costs to about $10.4 million and the work was completed in December 2007.

- In November 2005, Tobyhanna accepted an order totaling about $18.4 million to produce 3,954 light sets for the Army Communications-Electronics Life Cycle Management Command. The light sets are used to illuminate temporary facilities, such as tents and buildings. In order to produce the 3,954 light sets, the depot had to assemble almost 1 million new parts. According to depot officials and documentation, the order was originally expected to be completed by September 30, 2006, but the completion date was delayed by approximately 13 months because of problems obtaining parts from DLA. In order to meet the parts requirement, DLA ordered the parts from its suppliers with approximately 2 years delivery. Since the expected delivery dates did not meet the customer's delivery requirements, the depot canceled its order with DLA and ordered the parts directly from vendors to meet its production schedule. However, the vendor that produces approximately 80 percent of the parts could only provide enough parts for the production of 300 light sets a month. As a result, the depot carried over approximately $16 million from fiscal year 2006 into fiscal year 2007 and $1 million from fiscal year 2007 into fiscal year 2008.

  In October 2006, the depot accepted another order from the Army Communications-Electronics Life Cycle Management Command totaling about $5.9 million for an additional 1,069 light sets. Because of the unavailability of a sufficient quantity of parts from the vendor to satisfy the fiscal years 2006 and 2007 orders, the depot could not begin work on the October 2006 order until August 2007—approximately 10 months after the order was accepted. As noted previously, the DOD Financial Management Regulation includes requirements for accepting an order, including limiting acceptances to those orders that are expected to begin without delay (usually within 90 days). The depot carried over $5.4 million from fiscal year 2007 into fiscal year 2008. As of February 2008, the depot expected to complete the order by March 2008.

- In November 2006, Red River accepted an order totaling approximately $24.8 million to overhaul 200 M1114 up armor HMMWVs from the Army TACOM Life Cycle Management Command. The order was financed with fiscal year 2007 operation and maintenance appropriated funds and was modified twice. In January 2007, the order was reduced to overhaul 106 HMMWVs for about $13.1 million. Two months later in March 2007, the order was increased to 344 HMMWVs for about $56.1 million. In performing this work, the depot encountered two problems. First, the HMMWVs were not always available, resulting in changes to scheduling the performance of work. Second, the depot encountered problems in obtaining the material it needed to perform the repairs. For example, in May 2007, there was a shortage or potential parts shortage of 45 different parts to perform this work. To obtain the parts needed to perform the work, depot officials stated that they used parts from other vehicles at the depot or purchased parts via local procurement, including using government purchase cards. In August 2007, there was a shortage or potential parts shortage of 30 different parts. Since most of the work was not completed in fiscal year 2007, about $37.5 million carried over into fiscal year 2008. As of December 2007, documents showed that the depot anticipated completing work on this order in April 2008.

  In discussing the M1114 up armor HMMWV work with Red River officials, they told us that the problems encountered in performing the fiscal year 2007 work also occurred in the previous fiscal year. First, the quantity to be repaired kept changing. Specifically, in January 2006 they accepted an order to repair 37 HMMWVs. In March 2006, the order was amended to 108 HMMWVs. Then in July 2006 the order was amended to repair 58 HMMWVs. Finally, in August, 2006, the order was amended back to 108 HMMWVs. Second, the depot also encountered problems on obtaining parts to perform the work. According to depot officials, because the last amendment increasing the order to 108 HMMWVs occurred in August 2006 and the HMMWVs to be repaired were in poor condition, the carryover amount was high. The amount of work that carried over from fiscal year 2006 into fiscal year 2007 was $8.6 million of this $18.9 million order.

Army and DLA officials stated that in order to improve parts availability and reduce parts shortages, the Army and DLA are taking a number of actions. First, the Army depots and DLA are using a new tool that allows them to forecast spare parts requirements earlier in the process. Thus, they can better predict spare parts shortages and resolve them before the spare parts problems result in costly work-arounds or work stoppages at the depots. Second, DLA is establishing a greater presence at the depots to provide the depots and DLA greater visibility of spare parts requirements and to improve overall support to the depots. For example, DLA has added or is in the process of adding between two to eight personnel at each of the five depots to improve the forecasting of spare parts requirements and to expedite procurement of DLA- managed parts needed to meet the depots' immediate production requirements. Finally, DLA is working with its suppliers to identify alternative procurement sources and expedite parts delivery to avoid parts shortages at the depots.[12] While these are good first steps to help resolve the spare parts problems, it is too early to determine if they will succeed. Furthermore, the Army does not have quantifiable measures, such as comparing information in the critical maintenance repair parts reactive system from one period to another period, to determine the effectiveness of its actions to reduce the depots' critical spare parts problems.

Unserviceable Assets Scheduled for Repair Did Not Arrive at the Depots as Planned

One of the reasons cited in depot reports and by depot officials for carryover is that unserviceable assets (assets that need to be repaired) scheduled for repair did not arrive at the depots as planned. Our review of 53 depot reports issued in fiscal years 2006 and 2007 found that over two-thirds of the reports from the five depots cited deficiencies related to the lack of unserviceable assets for repair. For example, a Letterkenny report cited 115 fiscal year 2007 projects that were either delayed or canceled because of the lack of unserviceable assets for repair. In some cases, the lack of unserviceable assets either stopped or delayed depot production operations, resulting in increased carryover. The scope of our work did not include researching the customers' reasons for not sending the assets

[12] Our report, GAO, *Military Base Realignments and Closure: Transfer of Supply, Storage, and Distribution Functions from Military Services to Defense Logistics Agency*, GAO-08-121R (Washington, D.C.: Oct. 26, 2007), discussed DLA's ability to provide supplies to depots.

for repair as planned. However, Army officials informed us that in some cases the assets remained in-theatre (for example, in Iraq) for longer periods than planned.

While the depots have taken a number of actions to minimize production delays and carryover associated with the lack of unserviceable assets, the depots continue to report a lack of unserviceable assets. The following examples illustrate the impact on carryover when work was not performed because assets did not arrive at the depots as scheduled.

- In November 2005, Anniston accepted an order to overhaul 7 M1 tanks totaling about $6.4 million, which was financed with fiscal year 2006 Marine Corps Operations and Maintenance appropriated funds. The order was amended 9 times, increasing the quantity to 88 M1 tanks and increasing the amount of the order to about $86.6 million. During fiscal year 2006, the depot ordered about $8.8 million of material for this order with the first order for material occurring in April 2006. However, the first tank was not available for induction into the depot until December 2006, or 3 months into fiscal year 2007.[13] Our analysis of production documents on this order showed that the production schedule for performing the tank work continuously changed. Specifically, during fiscal years 2006 and 2007, depot production documents show that the production schedule changed 10 times because of customer requirements changing or the tanks not arriving at the depot as scheduled. Because the tanks were not available until fiscal year 2007, about $77.8 million of work (the amount of the order—$86.6 million—less the amount of material—$8.8 million) was carried over into fiscal year 2007. Although all the work was originally scheduled to be completed during fiscal year 2007, 17 tanks were not available for the depot to begin work on until fiscal year 2008, which resulted in almost $6.9 million being carried over into fiscal year 2008.

  The problem of production schedules changing that Anniston experienced in performing the tank work on the fiscal year 2006 order continued on a fiscal year 2007 order. In November 2006, the depot accepted another order totaling about $39 million, which was financed with fiscal year 2007 Marine Corps Operations and Maintenance appropriated funds to overhaul 36 M1 tanks. The order was amended five times during fiscal year 2007 increasing the quantity to 75 M1 tanks

[13] We did not assess whether the fiscal year 2006 order, as amended, reflected a bona fide need of that fiscal year.

and increasing the amount of the order to about $81.4 million. The amendments increased the quantities of tanks to be overhauled from 36 to 75 and amount of funding from $39 million to $81.4 million. To perform work on this order, during fiscal year 2007, the depot ordered material with the first order for material occurring in January 2007. However, the first tank was not available to be inducted into the depot until September 2007—the last month of the fiscal year. Our analysis of production documents on this tank order showed that the production schedule changed five times because of customer requirements changing or the tanks not arriving at the depot as scheduled. Because work on the tanks did not begin until the end of fiscal year 2007, about $71.3 million of work was carried over into fiscal year 2008. As of January 2008, the work is scheduled to be completed in May 2008 on this fiscal year 2007 order received in November 2006.

- In March 2006, Letterkenny accepted an order totaling about $12.3 million that was financed with fiscal year 2006 Army procurement aircraft funds for the repair of 100 aviation ground power units. Initially, the Aviation and Missile Life Cycle Management Command programmed the repair of the 100 aviation ground power units in fiscal year 2006. However, in March, April, and May 2006, the depot had received only 5 of the 100 unserviceable assets. The production controller stated that the power units were shipped to the depot in small quantities from many locations all over the world, which delayed the receipt of all 100 units. Thus, the depot production department revised its repair scheduled to complete 10 power units a month through March 2007. According to the production controller, many of the power units were not repaired in accordance with the revised schedule because (1) not all of the power units were received in time to meet the revised production schedule and (2) there was a lack of power units in inventory to exchange with the deploying units. As a result, about $6.3 million and $1.1 million carried over into fiscal years 2007 and 2008, respectively.

- In February 2004, Anniston accepted three orders totaling about $296,000 that were financed with fiscal year 2004 Procurement of Weapons and Tracked Combat Vehicles appropriated funds to overhaul 39 hydraulic cylinders on each order. Although the work was originally scheduled to be completed in June 2004, the work was not completed because some of the unserviceable assets did not arrive at the depot. As of August 2007, or about 3.5 years later, 36 hydraulic cylinders had not arrived at the depot for repair.[14] Consequently, about $83,000 of the $296,000 carried over into fiscal year 2008 on work that was originally planned to be completed in fiscal year 2004. In discussing this matter with the customer, TACOM Life Cycle Management Command, we asked them why it had not canceled the order since the depot did not receive some of the hydraulic cylinders after the appropriation financing the order had expired. Officials said that they did not want to cancel the order because they would lose the funds. After our discussion, the depot received 25 cylinder heads for two of the orders in the December 2007 and January 2008 time frame, and the depot completed the work on those assets in December 2007 or January 2008. As of January 2008, the depot has still not received 11 cylinder heads on this fiscal year 2004 order.

- In October 2006, Corpus Christi accepted an order from the Army Aviation and Missile Life Cycle Management Command to repair 150 T700 engine cold section modules totaling about $15.6 million. A depot official stated that the depot planned to complete the order by the end of October 2007. The depot initially expected to carryover 15 T700 engine cold section modules from fiscal year 2007 into fiscal year 2008 at an estimated value of approximately $1.6 million. However, primarily because of the lack of unserviceable assets to repair, the depot carried over 46 T700 engine cold section modules at an estimated value of $4.7 million—an increase in the depot's carryover of approximately $3.1 million. The depot completed the order in December 2007.

In order to manage unserviceable assets and minimize carryover, the depots took a number of actions on a daily, weekly, monthly, and quarterly basis. For example, on a daily basis, (1) programs were reviewed for asset availability and (2) if it was determined that there was a shortage of assets, the item manager was notified. On a weekly basis, schedules were adjusted based on requirements and asset availability. On a quarterly basis, in-process reviews were held with the depots and the life cycle management commands, and issues affecting production were discussed.

[14] We did not assess whether the fiscal year 2004 orders reflected a bona fide need of the fiscal years for which the procurement funds were available.

Conclusions

Continuing problems in the Army depot maintenance group's ability to control the growth of carryover has resulted in excess carryover amounts that tie up customer appropriations for long periods of time. Further, we noted the lack of transparency with the level of detail of carryover data reported to Congress for oversight purposes. Without increased management attention, Army depot maintenance carryover amounts will continue to escalate, as illustrated by the significant growth in carryover in fiscal years 2006 and 2007. Much of the growth in carryover results from the growth in new orders brought on by increased federal expenditures related to the war effort in Iraq and Afghanistan. Nonetheless, some of the factors that led to increased carryover are, in part, within DOD's and, more specifically, the Army depots' control. Most notably, the Army depots have not started orders within a few months of acceptance and completed them in a timely manner. While the Army's initial actions in fiscal year 2008 to reduce carryover at the Army depots resulted in some improvement, these actions have not yet fully met the goals included in its carryover reduction plan.

Recommendations for Executive Action

In order to (1) improve the reliability and level of detail of carryover amounts reported to Congress and DOD decision makers and (2) reduce carryover associated with the Army depot maintenance working capital fund activities, we are making eight recommendations to the Secretary of Defense.

We recommend that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to take the following actions:

- Establish a mechanism to monitor whether activities are not following the existing July 2003 policy that prohibits the deobligating and reobligating of funds at year-end for the sole purpose of reducing carryover balances and take appropriate actions, such as reducing future funding designated for these activities, if they do not follow the policy.

- Establish procedures requiring evaluations of future exemption requests on carryover to consider the impact these requests have on the actual carryover balances reported to Congress and whether granting such exemptions substantially reduces the visibility over and financial incentive to resolve long-standing issues, such as spare parts problems.

We recommend that the Secretary of Defense direct the Secretary of the Army to take the following actions:

- Direct the Army headquarters budget office to compare the amounts contained in the Army's carryover reduction plan to reported actual execution data on a monthly basis to determine (1) if the depots met established targets and (2) if the overall plan's execution has the desired effect of reducing fiscal year 2008 year-end carryover, and work with the Army Materiel Command and the Army depots to identify ways to further reduce fiscal year 2008 carryover if monthly revenue goals are not met.

- Establish procedures for separately identifying the allowable and reported actual amounts of carryover for the Army depot maintenance activities in the Army's annual budget to Congress (as was done prior to fiscal year 2005).

- Issue guidance, in accordance with existing DOD-wide guidance, that prohibits the Army Industrial Operations activity group from deobligating reimbursable customer orders at the end of the fiscal year and reobligating them in the next fiscal year for the sole purpose of reducing carryover balances that are ultimately reported to Congress.

- Develop a mechanism to monitor the Army depot maintenance activities' compliance with the requirements in DOD Financial Management Regulation 7000.14-R governing acceptance of orders, particularly when work is not expected to (1) begin without delay (usually within 90 days of acceptance) and (2) be completed within the normal production period for the specific work ordered.

- Establish procedures requiring Army headquarters and Army Materiel Command to compare budgeted orders to actual orders that the depots received from customers and consider these trends in developing the following year's budget estimates on new orders to be received from customers.

- Develop quantifiable measures to determine the effectiveness of actions taken by the Army and DLA to resolve spare parts shortages, such as analyzing the information on customer orders with insufficient spare parts in the critical maintenance repair parts reactive system at the end of fiscal year 2008 and comparing the results to those of prior fiscal years.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report. DOD concurred with six recommendations and partially concurred with the specific aspects of recommended actions for two. However, in its response, DOD cited actions under way, or planned, related to all eight recommendations, including

- establishing an Army program to monitor carryover information throughout the fiscal year;
- providing separate carryover rates for depot maintenance and ordnance in upcoming budgets of the President;
- issuing an Army memorandum emphasizing the department's policy prohibiting the deobligating of funds late in the fiscal year and then reobligating the same funds in the following fiscal year in order to reduce carryover amounts; and
- developing a method that will identify the amount of carryover resulting from spare parts shortages.

DOD partially concurred with two of our recommendations with respect to whether (1) it can establish a mechanism to detect manipulation of carryover balances and (2) that additional procedures are required to ensure that evaluations of future exemption requests consider the impact of granting such requests will have on congressional reporting.

DOD agreed that the Army must comply with the departmental financial policy that prohibits deobligating and reobligating funds at year-end to reduce carryover balances, but stated that there is no cost-effective method to detect non-compliance. DOD stated it plans to reiterate its existing policy and re-instruct the components to verify compliance with this policy as part of their internal control reviews. It stated the Office of the Under Secretary of Defense (Comptroller) will require the Army to certify compliance with DOD regulations and will evaluate and take appropriate actions on any future violations of the regulations. These additional planned DOD actions are consistent with the intent of our recommendation to establish an oversight mechanism.

On DOD's partial concurrence with our recommendation to establish procedures requiring evaluations of future exemptions requests on carryover and to consider the impact these requests have on actual carryover balances, DOD stated that it partially concurred because it already has procedures in place. It stated that exemptions are given on a case-by-case basis and only for limited periods. In addition, DOD stated it plans to monitor and take appropriate actions on the Army's efforts to reduce carryover caused by parts shortages. However, as discussed in our draft report, the exemptions do not provide the right incentives to correct long-standing problems associated with receiving orders from other services late in the fiscal year and program delays caused by long lead time material. Consequently, we continue to believe that DOD should direct the Under Secretary of Defense (Comptroller) to establish procedures requiring carryover-reporting exemption-request evaluations to consider the impact of granting such requests will have on carryover amounts reported to the Congress.

Finally, exceeding the annual carryover ceilings has been a long-standing problem at DOD. The department and the services have policies, procedures, and regulations that, in our view, adequately establish carryover ceilings and how to stay within those limits. Effective service implementation and timely DOD monitoring of service action shortly before, immediately after, and throughout each fiscal year are key to achieving compliance with established carryover policies and procedures. Unless DOD implements effective controls to monitor the services' actions, the Congress can not be assured that the department is truly committed to reducing the growth of excessive carryover.

We are sending copies of this report to the Chairmen and Ranking Members of the Senate Committee on Armed Services; the Subcommittee on Defense, Senate Committee on Appropriations; the House Committee on Armed Services; the Subcommittee on Readiness, House Committee on Armed Services; the House Committee on Appropriations; and the Subcommittee on Defense, House Committee on Appropriations. We are also sending copies to the Secretary of Defense, Secretary of the Army, and other interested parties. Copies will be made available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

Should you or your staff have any questions concerning this report, please contact Paula M. Rascona at (202) 512-9095 or rasconap@gao.gov or William M. Solis at (202) 512-8365 or solisw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix III.

Paula M. Rascona
Director, Financial Management and Assurance

William M. Solis
Director, Defense Capabilities and Management

Appendix I: Scope and Methodology

To determine the growth in reported total carryover from fiscal year 2004 through fiscal year 2007 and the actions the Army is taking to reduce the carryover, we obtained and analyzed Army depot maintenance reports that contained information on new order, revenue, and carryover data for the 4-year period. We also met with Army officials to discuss its plans for reducing carryover in fiscal year 2008 and obtained and analyzed the Army's plans for reducing carryover. Further, we analyzed the Army's plan and first quarter fiscal years 2007 and 2008 execution data to determine if the depots met their first quarter fiscal year 2008 targets. Finally, we met with officials at the five Army depots to determine (1) what specific actions the depots took to reduce carryover in the first quarter of fiscal year 2008; (2) if the depots did not meet the planned targets for the first quarter of fiscal year 2008, the reasons for missing the targets; and (3) whether the depots' officials believe that they will meet production targets for the fiscal year.

To determine whether reported carryover amounts exceeded carryover ceilings for fiscal years 2006 and 2007 and adjustments made to reduce those amounts, we obtained and analyzed the allowable amount of carryover and reported actual year-end carryover for those years. We focused on fiscal years 2006 and 2007 because this is the time period when the carryover significantly increased. We also identified and analyzed the amount of carryover the Army exempted from its carryover calculation that was approved by the Office of the Under Secretary of Defense (Comptroller) for fiscal years 2006 and 2007. When the reported actual carryover exceeded the carryover ceiling, we met with responsible officials at the Army depots, the Army Materiel Command, and Army headquarters to ascertain why the depots exceeded the ceiling. We reviewed our prior reports (GAO-01-559, GAO-05-441, and GAO-06-530) on carryover, which provided information on the allowable amount of carryover as well as reported actual year-end carryover data. Finally, we identified year-end transactions that reduced the dollar amount of reported actual carryover in September 2006 and reobligated these funds in the beginning of October.

To determine the primary reasons for the increased carryover at the five Army depots, we met with Army headquarters budget officials and responsible budgeting, accounting, or production officials at the Army depots. Based on those discussions, we obtained information that affected carryover. First, we analyzed budgeted and reported actual new orders to determine if the Army underestimated the depots' fiscal years 2006 and 2007 workloads. When large differences occurred between budgeted and reported actual new orders, we met with Army headquarters officials to determine the reasons for these differences. Second, we identified orders received by the depots late in the fiscal year to determine if these orders were contributing to the carryover. Third, we analyzed reports and data files that provide information on the status of production work at the depots to determine if there were parts shortages resulting in carryover. In performing this work, we met with Defense Logistics Agency officials at the depots to discuss problems with the Defense Logistics Agency providing spare parts to the depots. Fourth, we analyzed reports that provide information on the status of production work at the depots to determine if the lack of unserviceable assets to be repaired at the depots contributed to carryover.

We performed our work at the headquarters of the Office of the Under Secretary of Defense (Comptroller) and the Office of the Secretary of the Army, Washington, D.C.; Army Materiel Command, Fort Belvoir, Virginia; the Tobyhanna Army Depot, Tobyhanna, Pennsylvania; the Letterkenny Army Depot, Chambersburg, Pennsylvania; the Corpus Christi Army Depot, Corpus Christi, Texas; the Anniston Army Depot, Anniston, Alabama; and the Red River Army Depot, Texarkana, Texas. We conducted this performance audit from July 2007 through July 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Most of the financial information in this report was obtained from official Army budget documents and accounting reports. To assess the reliability of the data, we (1) reviewed and analyzed the factors used in calculating carryover, (2) interviewed Army officials knowledgeable about the carryover data, (3) reviewed GAO reports on Army depot maintenance activities, and (4) reviewed orders customers submitted to the depots to determine if they were adequately supported by documentation. We requested comments on a draft of this report from the Secretary of Defense or his designee. The Under Secretary of Defense (Deputy Comptroller) provided written comments, which are presented in the Agency Comments and Our Evaluation section of this report and are reprinted in appendix II.

Appendix II: Comments from the Department of Defense

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

JUN 24 2008

Ms. Paula M. Rascona
Director
Financial Management and Assurance
Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Ms. Rascona:

This is the Department of Defense response to the Government Accountability Office Draft Report 08-714, "ARMY WORKING CAPITAL FUND: Actions Needed to Reduce Carryover at Army Depots" dated May 14, 2008, (GAO Code 195119).

Actions to decrease carryover at the Army depots noted in the draft report are underway.

Sincerely,

John P. Roth

GAO DRAFT REPORT DATED MAY 14, 2008
GAO-08-714 (GAO CODE 195119)

"ARMY WORKING CAPITAL FUND: ACTIONS NEEDED TO REDUCE CARRYOVER AT ARMY DEPOTS"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION 1: The GAO recommends that the Under Secretary of Defense (Comptroller) establish a mechanism to monitor whether activities are not following the existing July 2003 policy that prohibits the de-obligating and re-obligating of funds at year end for the sole purpose of reducing carryover balances and take appropriate actions such as reducing future funding designated for these activities if they do not follow the policy. (p. 32/GAO Draft Report)

DOD RESPONSE: Partially concur. The Department agrees that the Army must comply with Department financial policies and regulations. However, there is no cost-effective method to detect non-compliance. To meet the intent of the recommendation, the Office of the Under Secretary of Defense (Comptroller) (OUSD(C)) will reiterate its current policy prohibiting the manipulation of customer order balances in an attempt to reduce reported carryover level. Furthermore, OUSD(C) will re-instruct Components to verify compliance with this policy as part of the required Internal Control Reviews. The OUSD(C) will direct the Army to certify compliance with Department Financial Management Regulations for FY 2008 and OUSD(Comptroller) will evaluate future carryover violations and take appropriate actions as warranted.

RECOMMENDATION 2: The GAO recommends that the Under Secretary of Defense (Comptroller) establish procedures requiring evaluations of future exemption requests on carryover to consider the impact these requests have on the actual carryover balances reported to Congress and whether granting such exemptions substantially reduces the visibility over and financial incentive to resolve long-standing issues, such as spare parts problems. (p. 32/GAO Draft Report)

DOD RESPONSE: Partially concur. The Department already has procedures in place that govern the evaluation of exemption requests regarding the carryover ceiling. Since the start of the current war, Components have presented written justification explaining the need to exempt certain workload from the carryover calculation. The OUSD(C) staff reviews the request and considers wartime requirements, production capability, and the efficiency and effectiveness of the depots before determining if approval will be given for a carryover exemption. Exemptions are given on a case-by-case basis and are usually only for limited periods. The OUSD(C) recognizes the importance of maintaining a proper level of carryover, remaining vigilant on the amount of carryover actually reported, and the forecasted carryover amount. The

Enclosure
Page 1 of 3

OUSD(C) will monitor Army's efforts to reduce carryover caused by parts shortages and take action as required.

RECOMMENDATION 3: The GAO recommends that the Secretary of the Army direct the Army headquarters budget office to compare the amounts contained in the Army's carryover reduction plan to reported actual execution data on a monthly basis to determine (1) if the depots met established targets and (2) if the overall plan's execution has the desired effect of reducing FY 2008 year end carryover, and work with the Army Materiel Command and the Army depots to identify ways to further reduce FY 2008 carryover if monthly revenue goals are not met. (p. 33/GAO Draft Report)

DOD RESPONSE: Concur. The Secretary of the Army has initiated a program to monitor carryover information throughout the fiscal year. The Army has established a Depot Maintenance Execution Council that meets monthly to discuss the actual versus planned carryover amounts and the impact of new orders on the estimated carryover amount.

RECOMMENDATION 4: The GAO recommends that the Secretary of the Army establish procedures for separately identifying the allowable and reported actual amounts of carryover for the Army depot maintenance activities in the Army's annual budget to Congress (as was done prior to FY 2003). (p. 33/GAO Draft Report)

DOD RESPONSE: Concur. Because Army Depot Maintenance has a basic repair mission, a Reset mission associated with the Global War on Terror, and a Recapitalization mission, while Ordnance has a manufacturing and a storage mission, a separate carryover rate for Depot Maintenance and a carryover rate for Ordnance will be proposed in the upcoming President's Budget.

RECOMMENDATION 5: The GAO recommends that the Secretary of the Army issue guidance, in accordance with existing DoD-wide guidance, that prohibits the Army Industrial Operations activity group from de-obligating reimbursable customer orders at fiscal year end and re-obligating them in the next fiscal year for the sole purpose of reducing carryover balances that are ultimately reported to Congress. (p. 33/GAO Draft Report)

DOD RESPONSE: Concur. The Secretary of the Army will issue a memorandum emphasizing the Department's policy prohibiting the de-obligating of funds late in the fiscal year and then re-obligating the same funds in the following fiscal year in order to reduce the reported carryover amount. The Army will also conduct spot checks at the depots to ensure compliance.

RECOMMENDATION 6: The GAO recommends that the Secretary of the Army develop a mechanism to monitor the Army depot maintenance activities' compliance with the requirements in the DoD Financial Management Regulation 7000.14-R governing acceptance of orders, particularly when work is not expected to (1) begin

Enclosure
Page 2 of 3

without delay (usually within 90 days of acceptance) and (2) be completed within the normal production period for the specific work ordered. (p. 33/GAO Draft Report)

DOD RESPONSE: Concur. The DoD Financial Management Regulation, Volume 11A, Chapter 2 (Project Orders) and 3 (Economy Act Orders), clearly specifies the criteria that governs the issuance and acceptance of Project Orders and Economy Act orders. The Secretary of the Army will issue additional guidance reiterating the conditions that must be followed when accepting Project or Economy Act Orders.

RECOMMENDATION 7: The GAO recommends that the Secretary of the Army establish procedures requiring Army headquarters and Army Materiel Command to compare budgeted to actual orders the depots received from customers and the consideration of these trends in developing the following year's budget estimates on new orders to be received from customers. (p. 34/GAO Draft Report)

DOD RESPONSE: Concur. The Secretary of the Army has established procedures that will compare forecasted customer orders contained in the budget to actual orders received from customers during the fiscal year. This comparison will provide trend analysis to be applied in the budget development process which will improve the accuracy and validity of forecasted customer orders in the President's Budget.

RECOMMENDATION 8: The GAO recommends that the Secretary of the Army develop quantifiable measures to determine the effectiveness of actions taken by Army and Defense Logistics Agency to resolve spare parts shortages, such as analyzing the information on customer orders with insufficient spare parts in the critical maintenance repair parts reactive system at the of FY 2008 and comparing the results to prior fiscal years. (p. 34/GAO Draft Report)

DOD RESPONSE: Concur. The Secretary of the Army has developed quantifiable measures to monitor the effectiveness of actions taken by the Army and the Defense Logistics Agency regarding the shortage of spare parts. The Army has a stock availability metric that measures the percentage of stock on hand to fill immediate requirements. The Defense Logistics Agency has an acceptance rate which measures the percentage of orders that DLA can fill. In addition, the Army will develop a method that will identify the amount of carryover resulting from spare parts shortages. This will allow the Army to initiate actions with the Army Supply business activity or DLA to correct these problems.

Enclosure
Page 3 of 3

Appendix III: GAO Contacts and Staff Acknowledgments

GAO Contacts

Paula M. Rascona, (202) 512-9095 or rasconap@gao.gov

William M. Solis, (202) 512-8365 or solisw@gao.gov

Acknowledgments

In addition to the contacts named above, Greg Pugnetti, Assistant Director; Richard Cambosos; Francine DelVecchio; Steve Donahue; Keith McDaniel; and Hal Santarelli made key contributions to this report.

(195119)

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "E-mail Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, DC 20548

To order by Phone:	Voice:	(202) 512-6000
	TDD:	(202) 512-2537
	Fax:	(202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

PRINTED ON RECYCLED PAPER