



Accounting and Information
Management Division

B-279141

August 28, 1998

The Honorable William Lynn
Under Secretary of Defense (Comptroller)

Subject: Financial Management: Accounting Implications of DOD's Facilities
Demolition Programs

Dear Mr. Lynn:

The Secretary of Defense has designated facilities demolition as an important element of the Department of Defense's (DOD) strategy to improve facilities management and reduce maintenance costs. The military services have programs in place to identify unneeded facilities on active bases that the services intend to dispose of through demolition. In general, the objectives of the services' programs are to demolish facilities that are (1) in excess of current requirements, (2) costly to maintain and operate, (3) unsafe or potentially harmful to the environment, and (4) unsightly and not in keeping with the concept of "installations of excellence."

Properly accounting for facilities demolition will entail consideration of several issues, including how and when to record assets, liabilities, and depreciation. DOD is currently updating its Financial Management Regulation¹ to incorporate the requirements of the new federal accounting standards, some of which address how the military services should account for their facilities and their demolition programs. This letter presents information that the Department should consider in formulating those accounting policies and related guidance.

FACILITIES DEMOLITION PROGRAMS HAVE
SEVERAL ACCOUNTING IMPLICATIONS

Facilities are considered general property, plant, and equipment, and facilities demolition is subject to the accounting requirements found in Statements of

¹The Financial Management Regulation, issued under the authority of Instruction 7000.14, provides all DOD components with the policies, regulations, and procedures within the area of responsibility of the DOD Comptroller.

Federal Financial Accounting Standards (SFFAS) No. 5, Accounting for Liabilities of the Federal Government, and No. 6, Accounting for Property, Plant, and Equipment. The accounting treatment for facilities scheduled for demolition depends on whether or not those facilities still contribute to the department's operations. For facilities that contribute to an agency's operation, SFFAS No. 6 requires that the assets and any related capital improvements be depreciated over the assets' remaining estimated useful lives. DOD has issued a proposed depreciation policy that would require the military services to depreciate general property, plant, and equipment beginning with their fiscal year 1998 financial statements. In addition, SFFAS No. 6 requires that an estimate of deferred maintenance related to general property, plant, and equipment be presented in a footnote that is referenced in the statement of net cost. Deferred maintenance is maintenance that was not performed when it should have been or was scheduled to be but was delayed until a future period.²

Facilities that no longer contribute to an agency's operations because they have become obsolete or have been identified as excess are characterized in SFFAS No. 6 as awaiting "disposal, retirement or removal from service." The standard requires that these facilities be removed from the general property, plant, and equipment accounts along with any associated depreciation. For these facilities, deferred maintenance is no longer relevant and therefore should also be removed from disclosure information. In general, facilities awaiting disposal through sale, trade, or donation would be recorded in a separate asset account at their expected sales or salvage values less any costs necessary to prepare the facilities for disposal. No additional depreciation should be recorded for these assets, and additional deferred maintenance should not be disclosed.

While facilities that no longer contribute to operations and that will be disposed of through the demolition program have no net sales or salvage value, they do have an associated cost that must be accrued and reported in accordance with SFFAS No. 5. The two key criteria cited in SFFAS No. 5 for a reportable liability are that a future cost is probable and that it is estimable. The facilities demolition liability is probable because DOD has determined that the future outflow of measurable resources is likely to occur and budget authority is routinely provided for this purpose. The military services have programs in

²We have issued several reports in the last 2 years that have identified deferred maintenance issues and reporting requirements. See Deferred Maintenance: Reporting Requirements and Identified Issues (GAO/AIMD-97-103R, May 23, 1997), Financial Management: DOD Needs to Expedite Plans to Implement Deferred Maintenance Accounting Standard (GAO/AIMD-97-159R, September 30, 1997), and Deferred Maintenance Reporting: Challenges to Implementation (GAO/AIMD-98-42, January 30, 1998).

place to identify unneeded facilities, and they have been demolishing these facilities for several years. For example, a recent survey by the military services identified about 8,300 buildings that would become excess or obsolete by January 1, 2000, and would be slated for demolition. Military service officials expect their demolition programs to continue to identify additional unneeded facilities. Also, any changes to the force structure could add to the number of unneeded facilities on active bases that could require demolition.

The second key criterion in SFFAS No. 5 for reporting a liability is that an amount be reasonably estimable. DOD has developed cost estimates for its facilities demolition program and used those estimates for budgetary and other purposes. For example, DOD estimated the cost of demolishing the approximately 8,300 identified excess facilities at \$548 million. Such estimates could serve as the starting point for developing an estimate of the facilities demolition liability for financial reporting purposes.

As DOD develops its implementing guidance for SFFAS Nos. 5 and 6, it will have to address at what point an unneeded facility that is a candidate for demolition no longer contributes to the organization and, therefore, should be treated as an asset awaiting disposal. For example, some demolition candidates are unoccupied, have not been used for years, and are no longer being maintained. In such cases, it is clearly required that those facilities be removed from the general property records along with any related depreciation and accumulated deferred maintenance and that disposal liabilities be established. At the other end of the spectrum, there are facilities that have been identified for future demolition but are still in use and may be undergoing maintenance as needed. Such facilities are probably still contributing to DOD's operations and therefore should not at this time be removed from the property, plant, and equipment records. DOD's guidance will need to address specific criteria for determining at what point facilities scheduled for demolition would cease being a general property asset and instead represent a disposal liability.

Thorough guidance will be critical to ensuring that the military services properly and consistently account for their facilities demolition programs. We are available to work with you as you update the Financial Management Regulation and develop the necessary implementing guidance.

AGENCY COMMENTS AND OUR EVALUATION

On August 13, 1998, the Under Secretary of Defense (Comptroller) provided oral comments on a draft of this report. He generally concurred with the contents. Specifically, he stated that the DOD Financial Management Regulation is being revised to incorporate the federal accounting standard requirements. In doing so, he said the Department will include accounting principles and policy on the

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measurement and recognition of costs associated with the demolition or other disposal of excess and/or obsolete structures. He added that the Department will also include accounting principles and policy on real property disposal including its treatment in the Standard General Ledger accounts.

To determine the accounting requirements related to the facilities demolition programs, we reviewed (1) relevant federal accounting standards requirements, (2) DOD's and the services' facilities disposal policies, procedures, and processes, and (3) congressional hearings which addressed DOD facilities' operation, maintenance, and repair, as well as unneeded facilities and related disposal issues. We interviewed DOD and military service officials responsible for facilities' management and the demolition programs and DOD officials responsible for financial reporting. We performed this work in conjunction with related work on the DOD fiscal year 1997 financial statement audits from August 1997 through June 1998, in accordance with generally accepted government auditing standards.

We are sending copies of this letter to the Air Force Assistant Secretary for Financial Management and Comptroller, the Army Assistant Secretary for Financial Management and Comptroller, the Navy Assistant Secretary for Financial Management and Comptroller, and the Director, Defense Finance and Accounting Service. Copies will be made available to others upon request.

This report was prepared under the direction of Molly Boyle, Assistant Director. Please contact Ms. Boyle or me at (202) 512-9095 if you have any questions about the report.

Sincerely yours,



fn Lisa G. Jacobson
Director, Defense Audits

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