United States General Accounting Office

GAO

Report to the Chairman, Subcommittee on Defense, Committee on Appropriations, House of Representatives

July 2003

NAVY WORKING CAPITAL FUND

Backlog of Funded Work at the Space and Naval Warfare Systems Command Was Consistently Understated

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GAO-03-668

July 2003

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Highlights

Highlights of GAO-03-668, a report to the Chairman, Subcommittee on Defense, Committee on Appropriations, House of Representatives

Why GAO Did This Study

The Space and Naval Warfare Systems Command (SPAWAR) has hundreds of millions of dollars of funded work that its working capital fund activities did not complete before the end of the fiscal year. Reducing the amount of workload carryover at fiscal year-end is a key factor in the effective management of Department of Defense (DOD) resources and in minimizing the "banking" of funds for work to be performed in subsequent years. GAO was asked to analyze SPAWAR's carryover balances. GAO assessed the accuracy of the budgeted amounts, the accuracy of the reported actual carryover balance, and the reliability of underlying financial data on which reported actual carryover is based.

What GAO Recommends

GAO is making several recommendations aimed at improving the accuracy and reliability of SPAWAR's and other working capital fund activities' budgeted and reported actual year-end carryover amounts. GAO is also making recommendations to improve SPAWAR's tri-annual review process so that these reviews can serve to verify the reliability of underlying financial data. DOD concurred with 12 of the 14 recommendations and partially concurred with 2. For these 2 recommendations, DOD agreed with GAO's intent to ensure that obligated and unobligated balances are reviewed regularly to ensure effective use of funds.

www.gao.gov/cgi-bin/getrpt?GAO-03-668.

To view the full report, including the scope and methodology, click on the link above. For more information, contact Gregory D. Kutz at (202) 512-9505 or kutzg@gao.gov.

NAVY WORKING CAPITAL FUND

Backlog of Funded Work at the Space and Naval Warfare Systems Command Was Consistently Understated

What GAO Found

The budgeted and reported actual amounts of SPAWAR gross carryover were consistently understated, resulting in the Congress and DOD decision makers not having reliable information to decide on funding levels for working capital fund customers. First, GAO found that SPAWAR centers' budgeted gross carryover for fiscal years 1998 through 2002 was significantly less than the reported actual year-end gross carryover.

SPAWAR Systems Centers' Budgeted and Reported Actual Gross Workload Carryover

Dollars in millions

Fiscal year	Budgeted carryover	Actual carryover	Actual exceeds budgeted carryover
1998	$377	$530	$153
1999	332	563	231
2000	358	613	255
2001	567	875	308
2002	610	896	286

Sources: Navy budget and accounting reports.

Note: Gross carryover is the 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.

Budgeted gross carryover was understated primarily due to problems with estimating the underlying customer order data. For example, for fiscal year 2002, SPAWAR's budgeted amount for customer orders was 88 percent less than the reported actual orders received.

Second, SPAWAR's reported actual carryover balances were also unreliable and adjusted downward by hundreds of millions of dollars. These adjustments understated carryover and resulted in Navy reports to the Congress showing that SPAWAR carryover balances for fiscal years 1998 through 2002 did not exceed DOD's 3-month carryover standard. SPAWAR was able to report reduced carryover balances for the following reasons.

- As GAO previously reported, the DOD guidance for calculating the number of months of carryover allowed carryover to be adjusted and understated. DOD agreed with GAO's previous recommendation and in December 2002 changed its carryover guidance.
- SPAWAR centers used accounting entries to manipulate the amount of customer orders for the sole purpose of reducing reported carryover below the 3-month standard. For example, the centers did this for at least $50 million at the end of fiscal year 2001. SPAWAR officials issued guidance in September 2002 discontinuing this practice.

Finally, SPAWAR had not taken key steps to verify the underlying financial data on which reported actual carryover is based. The SPAWAR centers had only recently begun conducting the required tri-annual reviews of such data, which DOD has required since 1996. However, the reviews were ineffective, including the exclusion of slightly less than half of their reported actual carryover from the review process.

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

July 1, 2003

The Honorable Jerry Lewis
Chairman, Subcommittee on Defense
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This is the third in a planned series of reports that discusses the Defense Working Capital Fund fiscal year-end workload funding issue, generally referred to as "carryover." Section 1051 of the Floyd D. Spence National Defense Authorization Act For Fiscal Year 2001[1] required that we review various aspects of the Department of Defense (DOD) policy that allowed Defense Working Capital Fund activities to carry over a 3-month level of work[2] to ensure continuity of operations from one fiscal year to the next. Excessive amounts of carryover[3] financed with customer appropriations may indicate excessive or unneeded funds and are subject to reductions by DOD and the congressional defense committees during the budget review process. To the extent that carryover is high, the Congress may redirect the funds gained from such reductions to other priority initiatives.

In May 2001, we reported[4] that (1) DOD did not have a sound analytical basis for its 3-month carryover standard, (2) military services used different methods to calculate the number of months of carryover, and (3) some activity groups underestimated their budgeted carryover year after year, thereby providing decision makers with misleading year-end carryover information resulting in more funding being provided than was

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[1] Floyd D. Spence National Defense Authorization Act For Fiscal Year 2001, Pub. L. No. 106-398, Section 1051, 114 Stat. 1654, 1654A-264 (2000).

[2] DOD changed this policy in December 2002 by revising its methodology for calculating the allowable amount of carryover. Under the revised method, DOD eliminated the 3-month standard, and the allowable amount of carryover is to be based on the overall disbursement rate of the customers' appropriations financing the work.

[3] The carryover amount includes work for which customers have recorded obligations but the work has not yet started and the cost to complete work that has been started.

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

intended. In June 2002, we reported[5] on our review of the contract portion of the Air Force depot maintenance activity group. We found that the Air Force reported carryover balances were not reliable due to (1) faulty assumptions used in calculating work-in-process and (2) records not accurately reflecting work that was actually completed by fiscal year-end.

As requested and agreed to with your office, this report assesses carryover related to the Navy's Space and Naval Warfare Systems Command (SPAWAR) systems centers located at Charleston, South Carolina and San Diego, California. The SPAWAR systems centers have hundreds of millions of dollars of carryover and the carryover balance has been steadily increasing over the last 5 years. Our objectives were to determine if (1) differences existed between the budgeted and reported actual gross[6] carryover and, if so, the reasons for the variances, (2) the reported actual carryover balances accurately reflected the amount of work that remained to be accomplished, and (3) the SPAWAR systems centers had reliable underlying financial information to serve as the basis for reported actual carryover. Our review was performed from July 2002 through June 2003 in accordance with U.S. generally accepted government auditing standards. However, we did not fully validate the accuracy of the accounting and budgeting data referred to in this report, all of which were provided by the Navy. Further details on our scope and methodology can be found 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 (Comptroller) are reprinted in appendix II.

Results in Brief

We found that the budgeted and reported actual amounts of gross carryover were consistently understated, resulting in the Congress and DOD decision makers not having carryover information they need to make decisions regarding the level of funding to be provided to working capital fund customers. For fiscal years 1998 through 2002, SPAWAR systems centers reported that actual gross year-end carryover was substantially greater than their budgeted gross carryover. For example, for fiscal year

[5] U.S. General Accounting Office, *Air Force Depot Maintenance: Management Improvements Needed for Backlog of Funded Contract Maintenance Work*, GAO-02-623 (Washington, D.C.: June 20, 2002).

[6] Gross carryover is the 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.

2002, the Navy budget request estimated that the SPAWAR systems centers would have about $610 million in gross carryover, but the Navy subsequently reported that the centers actually had about $896 million—a difference of $286 million, or 47 percent.

The budget requests substantially underestimated gross carryover because the Navy also underestimated the dollar value of orders that the SPAWAR systems centers would receive from customers by hundreds of millions of dollars from fiscal years 1998 through 2002. For example, for fiscal year 2002, in formulating its budget request the Navy expected the SPAWAR systems centers to receive about $1.3 billion in customer orders, but the Navy reported that the centers actually received about $2.4 billion in customer orders—a difference of $1.1 billion, or 88 percent. The Navy underestimated customer orders from fiscal years 1998 through 2002 for the following reasons.

- The customers had consistently underestimated the amount of orders being placed with the SPAWAR systems centers.
- Orders received from certain Navy customers, called third-party customers, were not included in SPAWAR's budget.
- The Naval Computers and Telecommunications Command merged with SPAWAR systems centers, resulting in about $125 million of additional orders being received in fiscal year 2001 than were reflected in the systems centers' fiscal year 2001 budget request.
- The Navy changed its policy on performing work on certain types of orders placed with the San Diego Systems Center, resulting in more work being performed in the working capital fund than envisioned in the original budget estimates for fiscal years 2001 and 2002.
- The SPAWAR systems centers received about $167 million in orders financed with a supplemental appropriation in fiscal year 2002 that was not reflected in the budget.

In addition, we found that the systems centers' reported actual carryover balances were unreliable and adjusted downward by hundreds of millions of dollars because (1) DOD's guidance for calculating the number of months of carryover allowed these adjustments and (2) the systems centers manipulated customer work orders at year-end to reduce reported carryover.

- In May 2001, we reported[7] that DOD's guidance was not clear regarding the treatment of contractual obligations in calculating carryover. The number of months of carryover is a ratio of the dollar value of unfinished orders (numerator) at year-end to revenue earned for that fiscal year (denominator). Since DOD's guidance was unclear, the Navy reduced the dollar value of unfinished orders in the numerator related to contractual obligations but did not reduce revenue in the denominator by the amount of revenue earned from customers for contractual services. As a result of this practice and another discussed below, from fiscal years 1998 through 2002, the Navy was able to reduce SPAWAR's carryover balances below the 3-month standard. In May 2001, we also reported that the months of carryover reported by Navy activity groups, which include the SPAWAR systems centers, would more accurately reflect the actual backlog of in-house work if adjustments for contract obligations affected both contract carryover and contract revenue. The Office of the Under Secretary of Defense (Comptroller) agreed with our May 2001 report. DOD revised its carryover policy in December 2002, and the policy became effective with the fiscal year 2004 budget submission. Under the revised method, DOD eliminated the 3-month standard, and the allowable amount of carryover is to be based on the overall disbursement rate of the customers' appropriations financing the work. This policy, if implemented as designed, would eliminate the contractual obligation and related revenue problem discussed above. DOD is in the process of developing written procedures for implementing the new policy.

- We found that the two systems centers manipulated their reported carryover by making accounting entries at fiscal year-end that shifted reimbursable work (working capital fund) to direct cite work (direct appropriation) for the sole purpose of reducing reported carryover below the 3-month standard.[8] This practice resulted in the Navy providing misleading carryover information to the Congress and DOD. For example, the systems centers made these accounting entries at fiscal year-end 2000 for at least $38 million and at fiscal year-end 2001 for at least $50 million. SPAWAR officials told us that this has been a long-standing practice to reduce reported carryover below the 3-month

[7] GAO-01-559.

[8] Reimbursable work is work performed for the customer by the systems centers for which the customer pays the systems centers directly. Direct cite work is work performed for the customer by a private sector contractor, which bills the customer directly.

standard. After we discussed this with SPAWAR officials, guidance was issued discontinuing this practice beginning in fiscal year 2002.

Furthermore, the actual carryover data that the two SPAWAR systems centers reported were based on unreliable underlying financial data, in part, because the two centers had not fully complied with DOD's May 1996 guidance that requires them, and all other DOD fund holders, to conduct tri-annual reviews of commitments, obligations, and accrued expenditures to ensure the accuracy and timeliness of financial transactions. Specifically, our work showed that the two systems centers (1) did not begin conducting their reviews until September 2001 and September 2002—at least 5 years after the establishment of the DOD requirement, (2) excluded about 46 percent of their September 2002 reported actual carryover from their tri-annual reviews, (3) did not effectively review dormant obligations (obligations with balances that have not changed for more than 120 days) and, therefore, returned unneeded funds to customers after the funds had expired, and (4) were not effectively reviewing accrued expenditure data (accrued expenditures reduce carryover). We also found that neither SPAWAR headquarters nor the two systems centers' commanders had developed effective policies and procedures for ensuring that tri-annual reviews are conducted in accordance with DOD guidance and that timely and appropriate corrective action is taken on problems that are identified during the reviews.

We are making recommendations to the Secretary of Defense to (1) improve the reliability of reported carryover amounts to decision makers and (2) issue procedures for DOD's new carryover policy. We are also making a recommendation to the Secretary of the Navy to improve the management and reporting of budgeted and actual carryover by comparing budgeted orders to actual orders received from customers, and to consider these trends in developing the budget estimates on orders to be received from customers. We are also making recommendations to the Commanders of SPAWAR and one of the systems centers that are aimed at improving the effectiveness of their tri-annual reviews. In its comments on a draft of this report, DOD concurred with 12 of our 14 recommendations and partially concurred with the remaining 2 recommendations. For these 2 recommendations, DOD agreed with our intent to ensure that obligations, unobligated balances, and commitments are reviewed regularly to ensure effective use of funds. To that end, DOD said it would review its guidance to ensure clarity of intent.

Background

According to the Navy's fiscal year 2003 budget, the Navy Working Capital Fund will earn about $20.8 billion in revenue during fiscal year 2003. The Navy Working Capital Fund consists of the following six major activity groups: depot maintenance, transportation, base support, information services, supply management, and research and development. The Navy estimates that the research and development activity group will earn about $7.7 billion during fiscal year 2003, the largest activity group in terms of the dollar amount of revenue earned. This activity group includes the following subactivity groups: (1) the Naval Surface Warfare Center, (2) the Naval Air Warfare Center, (3) the Naval Undersea Warfare Center, (4) the Naval Research Laboratory, and (5) the Space and Naval Warfare Systems Centers.

The SPAWAR systems centers are the Navy's full-spectrum research, development, test and evaluation, engineering, and fleet support centers for command, control, and communication systems and ocean surveillance and the integration of those systems. The systems centers (1) support the fleet in mission and capability by providing capable and ready command and control systems for the Navy and (2) provide the innovative scientific and technical expertise and facilities necessary to ensure that the Navy can develop, acquire, and maintain the warfare systems needed to meet requirements. The SPAWAR systems centers' primary locations are in San Diego, California and Charleston, South Carolina.

Description of the Working Capital Fund Process of Setting Prices and Obligating Customer Funds

As part of the Navy Working Capital Fund, the SPAWAR systems centers rely on sales revenue rather than direct congressional appropriations to finance their operations. DOD policy requires working capital fund activity groups to (1) establish prices that allow them to recover their expected costs from their customers and (2) operate on a break-even basis over time—that is, not make a profit nor incur a loss. DOD policy also requires the activity groups to establish their sales prices prior to the start of each fiscal year and to apply these predetermined or "stabilized" prices to most orders received from customers during the year—regardless of when the work is actually accomplished or what costs are actually incurred.

Customers use appropriated funds to finance the orders placed with the SPAWAR systems centers. When a systems center accepts the customer order, its own obligational authority is increased and the customer's appropriation is obligated by the amount of the order. The working capital fund activity incurs obligations for costs, such as material and labor, to perform the work.

In addition to receiving orders from customers to do work as part of the working capital fund, SPAWAR systems centers also award hundreds of millions of dollars in contracts with the private sector for work to be performed for the centers' customers. These contracts and related work are not included in the working capital fund from a financial standpoint because the contractors directly bill the customers for work performed and the customers directly pay the contractors. DOD and the Navy refer to this process of awarding contracts for customers as direct cite orders, since the SPAWAR systems centers cite the customers' appropriation(s) on the contracts. The customers' funds are obligated when the systems centers award the contracts with contractors.[9]

What Is Carryover and Why Is It Important?

Carryover is the dollar value of work that has been ordered and funded (obligated) by customers but not yet completed by working capital fund activities at the end of the fiscal year.[10] Carryover consists of both the unfinished portion of work started but not yet completed, as well as requested work that has not yet commenced. To manage carryover, DOD converted the dollar amount of carryover to equivalent months of work. This was done to put the magnitude of the carryover in proper perspective. For example, if an activity group performs $100 million of work in a year and had $100 million in carryover at year-end, it would have 12 months of carryover. However, if another activity group performs $400 million of work in a year and had $100 million in carryover at year-end, this group would have 3 months of carryover.

[9] The systems centers charge customers a fee for awarding and administering these contracts.

[10] The two basic types of orders customers can place with a working capital fund activity are Project Orders and Economy Act orders, which are issued under the authority of Section 23 of Title 41, United States Code, and Section 1535 of Title 31, United States Code, respectively. These two types of orders are distinguished for accounting purposes by the period of time that the related funding is available for use by a working capital fund. For example, an Economy Act order funded by the Navy Operation and Maintenance appropriation that is not used (obligated) by the working capital fund activity by the end of the fiscal year is no longer available for new obligations and must be returned to the customer, absent some specific statutory authorization. However, the same appropriated funds used to finance a Project Order may be used (or "carried over") by the working capital fund activity to enter into new obligations in the next fiscal year.

The congressional defense committees and DOD have acknowledged that some carryover is necessary at fiscal year-end if working capital funds are to operate efficiently and effectively. In 1996, DOD established a 3-month carryover standard for all the working capital fund activities except for the contract portion of the Air Force depot maintenance activity group.[11] In May 2001, we reported[12] that DOD did not have a basis for its carryover standard and recommended that DOD determine the appropriate carryover standard for the depot maintenance, ordnance, and research and development activity groups. Based on our recommendation, in December 2002, DOD revised its carryover policy for working capital fund activities. Under the revised method, DOD eliminated the 3-month standard, and the allowable amount of carryover is to be based on the overall disbursement rate of the customers' appropriations financing the work. Too little carryover could result in some activity groups not having work to perform at the beginning of the fiscal year, resulting in the inefficient use of personnel. 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 minimizing the amount of the carryover, DOD can use its resources most effectively and minimize the "banking" of funds for work and programs to be performed in subsequent years.

Gross Carryover Budget Estimates Were Consistently and Substantially Understated

For fiscal years 1998 through 2002, SPAWAR systems centers' budgeted gross carryover was significantly less than reported actual gross carryover, thereby providing decision makers, including the Office of the Under Secretary of Defense (Comptroller) and congressional defense committees, misleading carryover information.[13] These decision makers use carryover information to determine whether the SPAWAR systems centers have too much carryover. If the systems centers have too much carryover, the decision makers may reduce the customers' budgets and use these resources for other purposes. For example, during its review of the fiscal

[11] The Air Force is the only military service that includes its contract depot maintenance operation in its working capital fund. To reflect this difference, DOD established a 4.5-month carryover standard to account for the additional administrative functions associated with awarding contracts. The Air Force is currently in the process of taking its contract depot maintenance operation out of the working capital fund.

[12] GAO-01-559.

[13] We previously reported on this issue in May 2001 in our report GAO-01-559.

year 2003 budget, the Office of the Under Secretary of Defense (Comptroller) noted that the Navy research and development activities carryover had been steadily increasing from about $2.2 billion in fiscal year 1997 to about $3.4 billion in fiscal year 2003. Since a significant portion of the carryover was related to work that was to be contracted out, the Office of the Under Secretary of Defense (Comptroller) reduced the customer funding by $161.1 million because these efforts could be funded in fiscal year 2004 with no impact on performance.

Customers' Underestimated Budgeted Orders Caused Understated Budgeted Gross Carryover

SPAWAR systems centers' reported actual year-end gross carryover was substantially greater than their budgeted gross carryover. Table 1 shows that from fiscal year 1998 through fiscal year 2002 reported actual gross carryover exceeded budgeted gross carryover, and the difference has increased from about $153 million to about $286 million.

Table 1: SPAWAR Systems Centers' Budgeted and Reported Actual Gross Carryover from Fiscal Year 1998 through Fiscal Year 2002

Dollars in millions

Fiscal year	Budgeted gross carryover[a]	Actual gross carryover[a]	Actual exceeds budgeted carryover
1998	$377	$530	$153
1999	332	563	231
2000	358	613	255
2001	567	875	308
2002	610	896	286

Sources: Navy budget and accounting reports.

[a]Gross carryover is the 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 Navy's budget requests consistently underestimated SPAWAR systems centers' gross carryover, in part, because the Navy consistently underestimated the amount of orders to be received from customers by hundreds of millions of dollars. Table 2 shows that the amount of difference between budgeted and reported actual orders increased from about $352 million (39 percent) in fiscal year 1998 to about $1.1 billion (88 percent) in fiscal year 2002. Since orders received from customers are the major source of funds for SPAWAR and one of the key factors in determining the amount of carryover at fiscal year-end, it is critical that the

Navy has accurate budget estimates on the amount of orders to be received from customers. However, for fiscal years 2000, 2001, and 2002 actual orders exceeded budgeted orders by at least 68 percent each year.

Table 2: SPAWAR Systems Centers' Budgeted and Reported Actual Orders Received from Customers for Fiscal Year 1998 through Fiscal Year 2002

Dollars in millions

	Fiscal year 1998[a]	Fiscal year 1999[a]	Fiscal year 2000[a]	Fiscal year 2001	Fiscal year 2002
Budgeted	$ 912	$ 913	$ 890	$1,226	$1,259
Actual	1,263	1,243	1,533	2,055	2,363
Difference	352	329	644	829	1,104
Percentage difference	**39**	**36**	**72**	**68**	**88**

Sources: Navy budget and accounting reports.

[a]Figures do not add due to rounding.

The data in table 2 indicate that the SPAWAR systems centers' customers have not accurately estimated the amount of orders they will place with the systems centers. Customers determine and justify their anticipated requirements for goods and services and the levels of performance they require from the systems centers to fulfill mission objectives. Our analysis of budget and accounting reports that provide information on customer orders shows that orders financed with three appropriations made up a large part of the differences in fiscal years 2000, 2001, and 2002. The appropriations used by customers to finance 49 percent to 67 percent of the differences for these 3 fiscal years were the

- Other Procurement, Navy appropriation;
- Research, Development, Test, and Evaluation, Defense appropriation; and
- Research, Development, Test, and Evaluation, Navy appropriation.

Reasons for Variances between Budgeted and Reported Actual Gross Carryover and Orders Received from Customers

Officials from the Charleston and San Diego Systems Centers and SPAWAR headquarters stated, and our work found, that customers have historically understated their budget estimates on customer orders that are received by the SPAWAR working capital fund. They stated that the systems centers' budgets for orders are based on what the customers tell them their requirements would be for a particular fiscal year. However, they also told us that customers are hesitant to make a full commitment to the estimated amount of work that will need to be performed.

SPAWAR and Navy headquarters budget officials acknowledged that the SPAWAR systems centers' budgets have consistently understated gross carryover and orders received from customers (claimants). They also stated that the dollar amount of orders that the systems centers receive from customers must match the dollar amount of orders that customers submit in their appropriated fund budgets. Customers only record in their budgets those orders that they will be sending directly to the systems centers. If a customer initially allocates budgeted funds to an activity not related to the working capital fund—which is a third party—and the third party places the order with a SPAWAR systems center, the customer's budget reflects that these funds went to a third party. This results in the amount of budgeted orders that the systems centers receive from customers being understated. Navy headquarters officials stated that this is not an easy problem to resolve because there are many customers and no one person or office is responsible for fixing the problem and it is hard to pinpoint which customers are not budgeting correctly.

Navy headquarters budgeting officials also stated that the fiscal year 2001 and 2002 budgets further understated gross carryover and orders for the following three reasons. First, the Naval Computers and Telecommunications Command merged with SPAWAR, which resulted in about $125 million of additional orders being received in fiscal year 2001 than was reflected in SPAWAR systems centers' budget. Second, the Navy changed its policy on work performed on certain types of work orders placed with the San Diego Systems Center. As a result, customers placed more orders for work that was contracted out by the working capital fund than was originally budgeted for in fiscal years 2001 and 2002. Third, the SPAWAR systems centers received $166.7 million in orders financed by the Defense Emergency Response Fund in fiscal year 2002 that was not reflected in the SPAWAR systems centers' budget. These funds were provided via a supplemental appropriation.

Navy headquarters officials were aware of this budgeting problem and issued guidance in March 2002 on preparing the fiscal 2004/2005 budget estimates that stressed the importance of customers accurately preparing budget estimates for orders placed with the Navy Working Capital Fund, including the SPAWAR systems centers. The guidance also stated that (1) it was imperative that all funds to be sent to the Navy Working Capital Fund be accurately reflected in the budget and (2) customers have historically underreported the funds to be placed with the Navy Working Capital Fund (particularly with the research and development business area that includes the SPAWAR systems centers) and overreported the use of these funds in other areas.

Reported Actual Carryover Balances Were Consistently Understated

In addition to understating budgeted gross carryover, SPAWAR systems centers also consistently understated their reported actual carryover. Inaccurate carryover information results in the Congress and DOD officials not having the information they need to perform their oversight responsibilities, including reviewing DOD's budget. Navy reports show that the systems centers' fiscal year-end carryover balances for fiscal years 1998 through 2002 did not exceed DOD's 3-month carryover standard. However, we found that the systems centers' reported carryover balances were understated because (1) DOD's guidance for calculating the number of months of carryover allowed this to happen and (2) the systems centers used accounting entries to manipulate customer work orders at year-end to help reduce reported carryover below the 3-month standard.

Defense Carryover Policy

Prior to 1996, if working capital fund activity groups' budgets projected more than a 3-month level of carryover, their customers' budgets could be, and sometimes were, reduced by the Office of the Under Secretary of Defense (Comptroller) and/or congressional committees. Because of the military services' concerns about (1) the methodology used to compute the months of carryover and (2) the reductions that were being made to customer budgets because of excess carryover, Defense performed a joint review[14] of carryover in 1996 to determine if the 3-month standard should be revised. Based on the joint review, DOD decided to retain the 3-month carryover standard for all working capital fund activity groups except Air Force contract depot maintenance.[15] Furthermore, as a result of the review and concerns expressed by the Navy, DOD also approved several policy changes that had the effect of increasing the carryover standard for all working capital fund activities. Specifically, under the policy implemented after the 1996 review, certain categories of orders, such as those from non-DOD customers, and contractual obligations, such as SPAWAR system centers' contracts with private sector firms for research and development work, can be excluded from the carryover balance[16] that is used to determine whether the carryover standard has been exceeded.

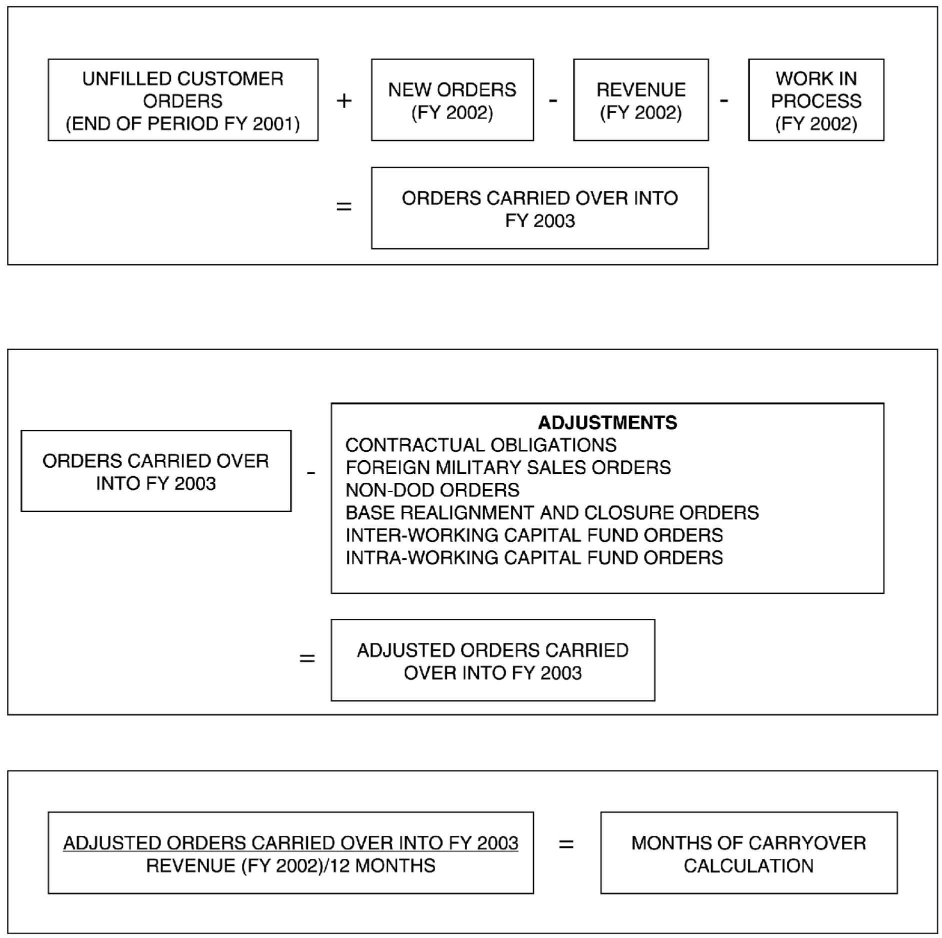
These policy changes were documented in an August 2, 1996, DOD decision paper that provided the following formula for calculating the number of months of carryover. (See fig.1.)

[14] This joint study group included representatives from the Office of the Secretary of Defense, the Office of the Joint Chiefs of Staff, and each of the military services.

[15] The Air Force is the only service that contracts out significant amounts of depot maintenance work through the working capital fund. Because of the additional administrative functions associated with awarding contracts, DOD set a 4.5-month carryover standard for Air Force contract depot maintenance. The Air Force is currently in the process of removing the contract portion of its depot maintenance operation from the working capital fund.

[16] Adjusted carryover is the obligated balance of budget authority carried over from one fiscal year to the next and adjusted for contractual obligations and certain categories of orders, such as those from non-DOD customers.

Figure 1: DOD Carryover Computation Based on the Fiscal Year 2002 Budget



Source: DOD and GAO.

Carryover Calculation Understated Reported Carryover

DOD's 1996 decision to allow certain categories of orders to be excluded (adjustments) from reported gross carryover has had a significant impact on SPAWAR systems centers' reported carryover, particularly the adjustment for contractual obligations. As table 3 shows, these adjustments have allowed the systems centers to significantly reduce actual reported gross carryover by hundreds of millions of dollars, resulting in reported carryover below the 3-month standard. As discussed below, we do not agree with how the Navy interpreted DOD's guidance for using contractual obligations and related revenue in calculating carryover. Our analysis of the systems centers' adjustments to their carryover amounts shown in table 3 found that contractual obligations accounted for 75 percent to 89 percent of the dollar adjustments made.

Table 3: SPAWAR Systems Centers' Reported Actual Gross Carryover before and after Adjustments for Fiscal Years 1998 through 2002

Dollars in millions

	Before adjustments		After adjustments	
Fiscal year	Dollars	Months	Dollars	Months
1998	$530	5.8	$196	2.1
1999	563	5.4	212	2.0
2000	613	4.8	243	1.9
2001	875	6.0	368	2.5
2002	896	4.5	421	2.1

Sources: Navy budget and accounting reports.

In May 2001, we reported[17] that the months of carryover reported by Navy activity groups, which include the SPAWAR systems centers, would more accurately reflect the actual backlog of in-house work if adjustments for contract obligations affected both contract carryover and contract revenue. As shown in figure 1, DOD's formula for calculating months of carryover is based on the ratio of adjusted orders carried over to revenue. The formula specifies that gross carryover should be reduced by the amount of contract obligations. However, DOD did not provide clear guidance on whether downward adjustments for the revenue associated with contract services should also be made. Unless this is done, the number of months of reported carryover will be understated.

In our May 2001 report we recommended, among other things, that the revenue used in calculating months of carryover be adjusted (reduced) for revenue earned for work performed by contractors. However, as discussed below, until recently DOD had not changed its policy for calculating carryover. As a result, the Navy did not adjust the revenue amount used in the denominator of the calculation and, therefore, continued to understate its reported carryover in its budget submissions to the Congress through fiscal year 2003. Navy officials informed us that they used total revenue in their calculation because total revenue represents the full operating

[17] GAO-01-559.

capability of a given activity group to accomplish a full year's level of workload. Further, even though Navy officials acknowledged that the revenue amount used in the calculation includes revenue earned from contracts, they stated the reason for not removing contract-related revenue from the denominator of the calculation was that the numerator of the calculation includes carryover (funds) related to work for which contracts would eventually be awarded but which had not yet been awarded at fiscal year-end. In addition, Navy officials told us that the accounting systems cannot readily break out what portion of the total revenue amount is contract-related. They further told us that the revenue information can be extracted from the system, but doing so involves a lot of work to develop the program(s) necessary to obtain the information.

When the Navy reduces the dollar amount of carryover (numerator) by the amount of contractual obligations and does not reduce the revenue amount (denominator) for revenue associated with contracts, it is not being consistent with the use of adjustments in the formula to calculate carryover. Because the Navy cannot readily determine the amount of contract-related revenue, we asked SPAWAR headquarters to estimate what the amount would be for the systems centers based on the same criteria they use to determine the dollar amount of contractual obligations to be deducted in the carryover calculation. SPAWAR's estimate shows that 63 percent of the total revenue amount used in calculating the SPAWAR systems centers' number of months of actual carryover reported for fiscal year 2002 is related to revenue associated with contractual services. By not reducing total revenue used in the calculation for revenue related to work performed by contractors, the systems centers' reported months of carryover for that fiscal year were understated.

In response to our May 2001 report, the Under Secretary of Defense (Comptroller) agreed that the methodology for calculating carryover needed to be revised. In December 2002, the Under Secretary of Defense (Comptroller) issued new guidance on carryover for working capital fund activities. Under the revised methodology, the formula shown in figure 1 has been eliminated and, therefore, working capital fund activities can no longer reduce reported carryover by the amount of their contractual obligations. DOD adopted the revised methodology for the Defense Working Capital Fund fiscal year 2004 budget estimates, but DOD has not yet issued written procedures to ensure that the services consistently implement the new policy. DOD officials informed us that they are developing the procedures and will update the appropriate regulations in 2004. We did not evaluate DOD's revised carryover policy.

Customer Orders Were Manipulated at Year-end to Reduce Reported Carryover

We also found that the systems centers reduced reported carryover by simply making accounting entries that took work to be performed by the working capital fund and turned it into work to be performed outside the working capital fund. Customer work that is performed by the working capital fund is referred to as reimbursable work. Customer work that is not performed by the working capital fund is referred to as direct cite work. Under the direct cite method of performing work, the working capital fund acts as an agent to get the work done through a private sector contractor. Customer funds that finance work done on a direct cite basis are not included in the working capital fund. Instead, the customer uses the direct cite funds to directly pay private sector contractors for the work performed rather than reimbursing or paying the working capital fund. Because the funds for direct cite work are not part of the working capital fund, there is no carryover associated with this work. Therefore, the work is not subject to DOD's 3-month carryover standard.

The two SPAWAR systems centers made some accounting entries at fiscal year-end that moved customer orders out of the working capital fund for the sole purpose of reducing reported carryover below the 3-month standard, which understated the amount of carryover that SPAWAR reported to the Navy and DOD. They then reversed these accounting entries in the beginning of the next fiscal year. Specifically, the systems centers did this at fiscal year-end 2000 for customer orders totaling at least $38 million and at fiscal year-end 2001 for orders totaling at least $50 million. SPAWAR systems centers' officials acknowledged that these accounting adjustments were made at fiscal year-end to reduce reported carryover. The officials told us that this has been a long-standing practice and was used as a "tool" to manage reported carryover. For example, comptroller officials at one systems center told us that as the fiscal year-end grew near, they had a good idea of how much they needed to move from reimbursable to direct cite in order to get down below the 3-month carryover standard. At year-end, if it was determined that they moved more funds than needed to get below the standard, they would move the excess back to reimbursable before the accounting period was officially closed.

We do not view these actions as a tool for managing workload as reflected by the reported carryover but as a misrepresentation of actual carryover balances in order to mislead decision makers, including DOD budget officials and the Congress. After discussing this practice with SPAWAR headquarters officials, they issued guidance in September 2002, prohibiting the use of reimbursable/direct cite accounting adjustments to mask year-end carryover balances. In discussing this with Navy headquarters and

DOD officials, they told us that they were not aware that the systems centers were doing this and that they did not agree with this practice.

Reported Actual Carryover Is Based on Unreliable Underlying Financial Data

In addition to understating budgeted and reported actual carryover information, the two SPAWAR systems centers' actual carryover data that were reported to the Congress as part of the President's budget were based on some unreliable underlying financial data. Although many factors could have contributed to this data problem, a primary cause was that the two centers had not fully complied with DOD guidance that required them and all other DOD fund holders[18] to conduct tri-annual reviews of their financial data (outstanding commitments, obligations, and accrued expenditures). In fact, although DOD established its tri-annual review requirement in 1996 in order to improve the timeliness and accuracy of its financial data, the Charleston and San Diego Systems Centers did not conduct their first reviews until September 2001 and September 2002, respectively. Further, as of September 2002, the systems centers were fully complying with only a few of the 16 specific tasks that they were required to accomplish during their reviews.

As discussed below, three carryover-related problems with the two systems centers' tri-annual reviews are that the centers (1) excluded about 46 percent of their reported actual carryover from their September 2002 tri-annual reviews, (2) were not effectively reviewing dormant obligations[19] and, therefore, were sometimes returning unneeded funds to customers after the funds had expired, and (3) were not effectively reviewing accrued expenditure data (accrued expenditures reduce carryover). A fourth problem was that neither SPAWAR headquarters nor the systems centers' commanders had developed effective policies and procedures for ensuring that (1) tri-annual reviews are conducted in accordance with DOD guidance and (2) timely and appropriate corrective action is taken on problems that are identified during the reviews.

[18] The fund holder is the organization on whose accounting records a commitment, obligation, and/or accrued expenditure is recorded.

[19] Obligations are considered dormant if their unliquidated balances have not changed for more than 120 days.

Effective Tri-Annual Reviews Can Result in More Informed Carryover-Related Budget Decisions and Other Benefits

The May 1996 memorandum from the Under Secretary of Defense (Comptroller) that established DOD's tri-annual review requirement noted that the timely review of commitments and obligations to ensure the accuracy and timeliness of financial transactions is a vital phase of financial management. To illustrate this point, the Under Secretary stated that the accurate recording of commitments and obligations (1) forms the basis for formal financial reports issued by the department and (2) provides information for management to make informed decisions regarding resource allocation.

Carryover-related budget decisions are examples of resource allocation decisions that require reliable obligation data. This is because there is a direct link between the (1) carryover data that working capital fund activities report to the Congress and DOD decision makers and (2) obligation data contained in the accounting records of working capital fund activities and their customers. Specifically,

- when working capital fund activities, such as the SPAWAR systems centers, accept customer orders, obligations are created in the customers' accounting records, and the systems centers become the "fund holders" and

- as work is performed and customers are billed, both the unliquidated obligation balances in the customers' accounting records and the working capital fund activities' reported carryover balances are reduced.

DOD's implementing guidance for the tri-annual reviews requires fund holders, such as the two SPAWAR systems centers, to certify that they completed 16 specific tasks during their reviews. For example, the guidance requires fund holders to confirm, among other things, that they have (1) traced the obligations and commitments that are recorded in their accounting systems back to source documents and (2) conducted adequate follow-up on all dormant obligations and commitments to determine if they are still valid.[20] Additionally, the guidance requires fund holders to

[20] All obligation and commitment balances that have not changed for more than 120 days are required to be reviewed during the 4-month period ending September 30 each fiscal year—but only those balances greater than a certain amount are required to be reviewed during each of the 4-month periods ending January 31 and May 31 of each fiscal year (e.g., for customer order-related obligations and commitments, the amount is $50,000).

(1) identify the problems that were noted during their reviews, (2) advise their higher headquarters—SPAWAR headquarters for the two systems centers—whether, and to what extent, adjustments or corrections to remedy noted problems have been taken, (3) summarize, by type, the actions or corrections remaining to be taken, (4) indicate when such actions/corrections are expected to be completed, and (5) identify the actions that have been taken to preclude identified problems from recurring in the future. Thus, if properly implemented, tri-annual reviews can provide a systematic process that helps fund holders not only improve the reliability of their financial data but also identify and correct the underlying causes of their data problems.

Tri-Annual Reviews Have Received Very Little Management Emphasis

As noted previously, DOD established the tri-annual review requirement in May 1996, but the Charleston and San Diego Systems Centers did not conduct their first reviews until September 2001 and September 2002, respectively. Discussions with SPAWAR officials and the centers' financial managers indicated that a lack of management emphasis is the primary reason for this delayed implementation.

For example, SPAWAR headquarters officials pointed out that the Navy's implementing guidance was not issued until July 2001—more than 5 years after DOD established the requirement, and San Diego Systems Center financial managers stated that they were not aware of the tri-annual review requirement until fiscal year 2001. Further, when Charleston and San Diego financial managers were asked why their centers did not conduct their first tri-annual reviews until the end of fiscal year 2001 and 2002, respectively, they stated that their personnel were busy reconciling data problems that were caused by multiple organizational consolidations and accounting system conversions, and indicated that their personnel did not have time to conduct tri-annual reviews.

DOD Guidance Allows a Substantial Amount of Carryover to Be Excluded from Tri-Annual Reviews

The SPAWAR systems centers' reported actual carryover falls into two major categories—obligated carryover and unobligated carryover. Obligated carryover refers to the portion of customer orders for which the systems centers have obligated their own funds. For example, if a customer submits a $1,000 order for engineering services, and a contractor will accomplish 10 percent of the work, then the systems center will award a contract for $100—which will obligate the center's funds—and the $100 will, therefore, be referred to as obligated carryover. A customer order's unobligated carryover balance is calculated by subtracting obligated carryover from the total amount remaining on the order—or $900 for this example. As of September 30, 2002, the two SPAWAR systems centers had about $896.1 million of reported actual carryover—$379.5 million of obligated carryover and $516.6 million of unobligated carryover.

The distinction between obligated carryover and unobligated carryover is important because (1) neither DOD nor Navy guidance explicitly requires the systems centers to review unobligated carryover during their tri-annual reviews (unless the work is recorded as a commitment in their accounting records) and (2) about $414 million of the systems centers' September 30, 2002, unobligated carryover was not recorded as a commitment in the centers' accounting records. In other words, even if the tri-annual reviews were performed effectively and in a timely manner, they would not cover about 46 percent of the systems centers' reported actual carryover.

DOD guidance does require customers, as part of their tri-annual reviews, to validate the orders they have placed with working capital fund activities because these orders are recorded as obligations in their accounting records, regardless of whether they are obligated or unobligated carryover in the working capital fund activities' records. However, customers have limited visibility over whether the unobligated portion of their funded orders are needed to finance future work, and, therefore, the working capital fund activities are in a better position than the customers to make this determination.

If the systems centers were required to review unobligated carryover balances when performing their tri-annual reviews, they could (1) reduce the amount of carryover on their records and (2) better identify unneeded funds and be in a better position to return them to customers before the funds expired[21] so the customers could use them for new obligations. For example, our review of 34 customer orders that (1) had $7 million of unobligated carryover balances as of September 30, 2001, and (2) were financed with funds that had already expired as of that date showed that most of the orders contained unneeded funds that were eventually returned to customers. Our analysis showed that (1) 27 of the orders (about 79 percent) had unneeded funds and (2) $2.9 million, or about 41 percent, of the orders we reviewed represented unneeded funds.

[21] The Congress generally provides budget authority to an agency for use during a specific period, referred to as the period of availability. During this period of availability, the agency may incur new obligations, for example, those for goods and services, and charge them against the appropriation. At the end of the period of availability, the appropriation expires, meaning that it may not be used to incur new obligations.

Although most of the unneeded funds we identified were eventually returned to customers, in some instances the funds were not returned until long after the funds expired. For example, $469,916 of unneeded funds on two Charleston Systems Center orders expired in September 2001, but was not returned to the customer until September 2002—almost 1 year after the funds had expired. Similarly, $71,718 of unneeded funds on a San Diego order expired in September 1998, but was not returned to the customer until December 2002—more than 4 years after the funds had expired.

We believe, and a senior DOD accounting official agreed, that the systems centers and other working capital fund activities should be required to validate their unobligated carryover during tri-annual reviews because, as noted previously, they have better visibility over whether unobligated funds will be needed in the future. However, neither center requires its managers to review unobligated carryover during the tri-annual reviews because, as financial managers at one center pointed out, they are concentrating on the requirements explicitly identified in the DOD guidance, and they will add other tasks, such as reviews of unobligated carryover, if and when (1) the guidance is changed or (2) they have the time and resources to do so.

More Effective Reviews of Dormant Obligations Could Result in More Effective Use of Customer Funds

A key element of the tri-annual reviews is the requirement to follow up on all obligations that have been dormant for more than 120 days to determine if unused funds are still needed. This task is one of the 16 tri-annual review requirements and is important from the systems centers' perspective because the identification and return of unneeded funds to the customer will reduce the centers' reported carryover—thereby reducing the likelihood of customers' budget cuts. Additionally, the task is important from the customers' perspective because the funds can be reused for other purposes if they are returned before they expire.

However, our analysis of the two centers' financial data and review of individual customer orders showed that neither center was effectively identifying unneeded funds and returning them to customers in a timely manner. For example, our analysis of the two systems centers' financial data showed that, as of September 30, 2002, the two centers had thousands of obligated carryover balances, valued at more than $7 million, that had not changed for more than a year. Further, some of these dormant balances were financed with customer funds that had long since expired. For example, 165 of the dormant carryover balances were financed with fiscal year 1996 or earlier appropriations. According to a systems center official, the monumental financial workload involved with the acquisition of additional activities and the transition to a consolidated financial accounting system occurring over the past several years greatly hindered their efforts to close all expired funding documents and return the unused funds to customers in a timely manner. For example, the official pointed out that the center had almost 13,000 old funding documents needing to be reconciled and closed at the start of fiscal year 2000 because of these problems and that the center was still working on them.

Large Accrued Expenditure Balances Warrant Increased Management Emphasis

At the conclusion of their tri-annual reviews, fund holders are required to certify that they have conducted adequate research on all accrued expenditures[22] that are more than 120 days old to determine if they are valid. This task is important because

- large accrued expenditure balances, in general, and large dormant accrued expenditure balances, in particular, can indicate either serious accounting problems or ineffective procedures for developing accrued expenditure schedules and

- accrued expenditures reduce reported carryover balances, and overly optimistic accrued expenditure schedules can, therefore, cause reported carryover to understate actual carryover.

The task of validating accrued expenditures is especially important for the two SPAWAR systems centers because they had about $673 million of accrued expenditures as of September 30, 2002.

However, the San Diego Systems Center, which had the larger accrued expenditure balance—about $423 million as of September 2002—is currently developing a methodology for validating its accrued expenditures. Further, although the Charleston Systems Center had developed a methodology to review its accrued expenditures, the Charleston Comptroller was concerned about the timeliness and adequacy of these reviews and, therefore, was unwilling to certify that the center adequately reviewed its dormant accrued expenditures.

[22] According to DOD's Financial Management Regulation 7000.14-R, Volume 1, accrued expenditures represent the amount of paid and unpaid expenditures for (1) services performed by employees, contractors, etc., (2) goods and tangible property received, and (3) amounts owed under programs for which no current service or performance is required.

Although the tri-annual review's tasks related to accrued expenditures focus primarily on accounting problems, reviews of dormant accrued expenditures are also important from a carryover perspective. Overly optimistic accrued expenditure schedules—which are the basis for determining when accrued expenditures will be recorded in the accounting system—can cause reported carryover to understate actual carryover. For example, if a contractor is to perform $600 of work, and an accrued expenditure schedule is based on the assumptions that the work will begin immediately and will be performed at a uniform rate over a 6-month period, then (1) $100 of expenditures will be accrued each month and (2) each accrued expenditure will trigger a $100 customer payment and, in turn, a $100 reduction in the reported carryover. Thus, after 4 months, the reported carryover will be $200, regardless of how much work has actually been accomplished. If the work begins later than expected or if it takes longer than expected to complete, and accrued expenditures are not adjusted accordingly, reported carryover would be understated.

Two ways to put the magnitude of the systems centers' accrued expenditure balances in perspective are to (1) compare the balances with other financial indicators and (2) show their impact on reported carryover. For example, the San Diego Systems Center's September 2002 accrued expenditure balance of $423 million is the equivalent of about 32 percent of the orders the center received during fiscal year 2002 ($1.315 billion) and about 31 percent of the revenue it received during the year ($1.372 billion). The accrued expenditures allowed the center to reduce its reported carryover at the end of fiscal year 2002 by about 3.7 months.

A San Diego Systems Center accounting official acknowledged that the center's large accrued expenditure balance is a major area of concern. Specifically, this official indicated that the center's large accrued expenditure balance is caused partly by delays in contractor and interfund billings, but acknowledged that there are other apparent problems that warrant attention. For example, the official said that the $405 million variance between the center's September 30, 2002, accrued expenditure and accounts payable balances is an apparent problem that should be reviewed.

However, the accounting official also pointed out that currently the center cannot analyze its accrued expenditures because its new accounting system, which has been tailored to meet its specific needs and is unique within DOD, cannot provide the data in a format that will allow it to do so. When asked what the San Diego Systems Center is doing to develop the data needed to effectively analyze its accrued expenditure data, the accounting official indicated that the center is developing a "data warehouse." However, the official acknowledged that (1) they have just begun identifying the specific requirements for the data warehouse, (2) there will be many competing requirements, (3) due to resource constraints, the data warehouse will not be able to satisfy all of the center's data analysis needs, and (4) they, therefore, do not know when or, for that matter, if they will ever have the data they need to effectively analyze their accrued expenditures.

Improvements Are Needed in SPAWAR's Tri-Annual Review Procedures

In addition to the major problems identified above, our review of the procedures that SPAWAR headquarters and its two systems centers use to conduct their tri-annual reviews identified several areas that need improvements. For example, SPAWAR headquarters has not evaluated the systems centers' reviews and, as a result, the command (1) does not have a sound basis for assessing the adequacy of the reviews that the centers have conducted on individual obligation, commitment, and accrued expenditure balances and (2) was not aware of the process-related problems discussed below.

San Diego's Decentralized Review Process Needs to Be Refined

The San Diego Systems Center accomplishes its tri-annual reviews on a decentralized basis. During the first step of the process, the Office of the Comptroller, which has overall responsibility for the reviews, develops computer lists that contain information on all of the center's outstanding obligations and commitments. The Comptroller's Office then provides these lists to the center's technical departments, which are then required to conduct the actual reviews. When the technical departments finish their reviews, their department heads certify that the reviews have been completed and then forward this certification to the San Diego Systems Center's Comptroller. On the basis of the technical departments' certifications, the Comptroller then certifies that the center has completed its review.

Although this approach seems reasonable on the surface, we found numerous problems with the process. For example, because the systems center's draft tri-annual review guidance does not specifically require the technical departments to accomplish many important tasks, the effectiveness and usefulness of the reviews varied significantly from one department to another. For example, two of the center's technical departments did not (1) summarize or analyze the results of their reviews, (2) establish internal controls to ensure that timely and appropriate corrective action was taken on problems that were identified during the reviews, or (3) maintain adequate documentation to show who conducted the reviews, what problems were identified, and/or what additional actions were required.

Conversely, although it was not required to do so, another department (1) summarized the results of its reviews in a single Excel spreadsheet to facilitate analysis of the review results, (2) analyzed the data to determine if there were any indications of systemic or compliance problems (e.g., inadequate reviews by one or more of the department's divisions or problems with accrual schedules), and (3) developed internal control procedures to ensure that timely and appropriate action was taken on identified problems and/or unresolved research requirements. Additionally, this department requires its managers to maintain documentation that (1) shows who conducted the actual reviews (so these individuals can be held accountable for the adequacy of the reviews), (2) identifies the additional research or corrective action that is required as a result of the reviews, and (3) indicates who is responsible for taking the action.

Managers from this department said that they were initially skeptical about the benefits of the tri-annual reviews, but indicated that they are now strong supporters because the reviews have provided a structured way to address their data problems and have already resulted in significant improvements in the quality of their data. Additionally, they acknowledged that documenting what corrective action is required and who is responsible for taking it requires additional time, at least in the short term. However, they believe this documentation is essential for (1) holding people accountable and (2) having effective internal controls to ensure that timely and appropriate corrective action is taken on the problems that are identified. Further, they believe that the documentation may save time in the long term because it will serve as a "memory jogger" for subsequent reviews.

Additional process-related problems we identified during our assessment of the San Diego Systems Center's tri-annual review process include the following.

- As noted previously, although the center had about $423 million of accrued expenditures as of September 2002, it had not yet developed a methodology for identifying and reviewing its accrued expenditures.

- Fund holders are required to conduct sufficient follow-up on dormant obligations and commitments to determine if they are still valid. However, the computer lists that the San Diego Comptroller provides to the center's technical departments do not distinguish between the obligations and commitments that have been dormant and those that have not. As a result, the technical departments have no way to focus their attention on the obligations and commitments that require follow-up action.

- The certifications that the department heads sign are much more general than the one that the Comptroller must sign on behalf of the system center and they, therefore, do not provide an adequate basis for the Comptroller's certification. For example, the Comptroller is required, among other things, to (1) advise SPAWAR headquarters whether, and to what extent, adjustments or corrections to remedy noted problems have been taken, (2) summarize, by type, the actions or corrections remaining to be taken, (3) indicate when such actions/corrections are expected to be completed, and (4) identify the actions that have been taken to preclude identified problems from recurring in the future. However, the Comptroller does not require the departments to report this information to him and, therefore, cannot report this information to SPAWAR headquarters.

- Although, as noted previously, the Comptroller has overall responsibility for the center's tri-annual reviews, his office has not assessed the adequacy of the reviews that are being conducted by the technical departments. As a result, the Comptroller does not have a sound basis for his certification.

Charleston's Basic Approach Is Sound, but Some Improvements Are Needed

The Charleston Systems Center has developed a basic approach for its tri-annual reviews that appears sound. Charleston's approach addressed several of the concerns we noted with the San Diego Systems Center's approach. First, rather than assigning all review requirements to the technical departments, Charleston divides the responsibilities between the Comptroller's Office and the technical departments. This approach allows the Comptroller's Office to concentrate on the tasks it is best qualified to perform, such as tracing obligations back to source documents, and lets the technical departments concentrate on those tasks that they are best qualified to perform, such as verifying that dormant obligations are still valid. Second, the Charleston Comptroller provides the technical departments with a list of all dormant commitments, obligations, and accrued expenditures so they can easily focus on those that they must follow up on. Finally, Charleston's tri-annual review guidance requires those who conduct the reviews to document actions taken during the reviews and is to (1) include corrective actions remaining to be taken and when such actions will be completed and (2) identify actions that have been taken to preclude identified problems from recurring in the future.

However, we did identify several problems with Charleston's overall approach. More specifically, we found the following:

- Although the Comptroller must sign a certification statement attesting to the results of the center's tri-annual review, the systems center has not conducted all of the required reviews, and the Comptroller has not developed internal control procedures to ensure that the reviews that were conducted were performed properly and completely.

- Charleston's technical department heads are responsible for ensuring that reviews are properly conducted and documented, but they are not required to certify that this has been done. Consequently, the Comptroller does not have a sound basis for certifying that the tri-annual review tasks the center is required to accomplish have been completed. In fact, Charleston's Comptroller acknowledged that our work shows that the technical departments' reviews are not adequate, and he indicated that his concern about the timeliness and adequacy of the technical departments' reviews is the reason why he has limited his tri-annual review certification to the 4 tasks that are under his control and why he has been unwilling to certify the remaining 12 tasks. The Comptroller stated, and we agree, that department heads should be held accountable for their respective departments' portion of the tri-annual review process. Specifically, he believes they should be required to complete and sign certification statements similar to the one that he must complete and sign on behalf of the systems center, and accordingly, has developed a proposed certification statement for the department heads to sign.

We also found that DOD's tri-annual review guidance regarding the dollar thresholds for reviewing outstanding commitments and obligations was unclear. The guidance states that during the January and May reviews, commitments and obligations of (1) $200,000 or more for investment appropriations (e.g., procurement funds and the capital budget of the working capital funds) should be reviewed and (2) $50,000 or more for operating appropriations (e.g., operation and maintenance funds and the operating portion of the working capital funds) should be reviewed.

Charleston interpreted the guidance to mean that customer orders—which are the operating portion of the working capital fund—financed with investment funds fell into the $200,000 threshold category for review purposes, rather than the $50,000 category, and conducted its tri-annual reviews accordingly. In discussing this issue with the Office of the Under Secretary of Defense (Comptroller) and Navy headquarters officials, the officials acknowledged that the guidance was unclear and, thus, open to interpretation. They stated that the guidance needed to be examined and clarified.

Conclusions

SPAWAR has consistently understated and provided misleading carryover information to the Congress. Reliable carryover information is essential for the Congress and DOD to perform their oversight responsibilities, including reviewing DOD's budget. To provide assurance that SPAWAR systems centers report reliable carryover information, managers at SPAWAR headquarters and the systems centers must be held accountable for the accuracy of reported carryover and ensure the timely identification of unneeded customer funds. This includes increased management attention that would provide more assurance that the systems centers are effectively reviewing funded orders as part of their tri-annual review process. Until these problems are resolved, the Congress and DOD decision makers will be forced to make key budget decisions, such as whether or not to enhance or reduce customer budgets, based on unreliable information.

Recommendations for Executive Action

We recommend that the Secretary of Defense

- direct the Secretary of the Navy to issue guidance to all Navy working capital fund activities, including SPAWAR, that prohibits them from deobligating reimbursable customer orders at fiscal year-end and reobligating them in the next fiscal year for the sole purpose of reducing carryover balances that are ultimately reported to the Congress;
- direct the Under Secretary of Defense (Comptroller) to determine the extent to which working capital fund activities throughout DOD may be similarly manipulating customer order data at fiscal year-end to reduce reported carryover and, if necessary, issue DOD-wide guidance prohibiting this practice as needed; and

- direct the Under Secretary of Defense (Comptroller) to develop and issue written procedures to implement the December 2002 carryover policy.

To provide reasonable assurance that the dollar amount of orders to be received from customers in developing annual budgets are based on more realistic estimates, we recommend that the Secretary of the Navy direct the Commander of the Space and Naval Warfare Systems Command to compare budgeted to actual orders received from customers and consider these trends in developing the following year's budget estimates on orders to be received from customers.

We recommend that the Under Secretary of Defense (Comptroller)

- revise the tri-annual review guidance in the DOD Financial Management Regulation so that working capital fund activities are required to expand the scope of their tri-annual reviews to include unobligated balances on customer orders and

- review and clarify the tri-annual review guidance for the January and May reviews in the DOD Financial Management Regulation as it pertains to the dollar threshold for reviewing outstanding commitments and obligations for the capital budget and operating portion of the working capital fund.

We recommend that the Commander of the Space and Naval Warfare Systems Command establish internal control procedures and accountability mechanisms that provide assurance that the systems centers are complying with DOD's tri-annual review guidance.

We also recommend that the Commander of the Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers to

- maintain documentation that shows who conducted the tri-annual reviews so that these individuals can be held accountable for the reviews;

- maintain documentation that identifies (1) any additional research or corrective action that is required as a result of the tri-annual reviews and (2) who is responsible for taking the action;

- require cognizant managers, such as department heads, to confirm in writing that they have (1) performed the required tri-annual reviews and (2) completed the related follow-up actions by signing a statement, such as the draft certification statement developed by the Charleston Systems Center Comptroller, that describes the specific tasks that were accomplished and provide this statement to the systems centers' comptrollers;

- develop and implement internal control procedures to provide assurance that tri-annual reviews of individual commitment, obligation, and accrued expenditure balances are adequate; and

- develop policies and procedures to capture the information on tri-annual review results, such as the amount of obligations reviewed, confirmed, and revised, that they are required to report to SPAWAR headquarters and that SPAWAR headquarters, in turn, is required to report to Navy headquarters.

We recommend that the Commander, San Diego SPAWAR Systems Center direct the Center Comptroller to

- develop and implement a methodology for identifying and analyzing accrued expenditure balances and

- identify dormant commitments, obligations, and accrued expenditures in the tri-annual review computer lists that are provided to the technical departments.

Agency Comments and Our Evaluation

DOD provided written comments on a draft of this report. In its comments, DOD concurred with 12 of our 14 recommendations and partially concurred with the remaining 2 recommendations. For these 2 recommendations, DOD agreed with our intent to ensure that obligations, unobligated balances, and commitments are reviewed regularly to ensure effective use of funds. Our evaluation of DOD's comments is presented below. DOD's comments are reprinted in appendix II.

For the 12 recommendations with which DOD concurred, it stated that 7 of them were completed based on the issuance of SPAWAR Instruction 7301.1A on Tri-Annual Reviews of Commitments and Obligations, dated October 9, 2002. We believe that the guidance provided in the instruction is an important step. SPAWAR and the systems centers now need to develop and issue implementing procedures because, in most cases, the guidance provided in the instruction that is related to these 7 recommendations is too general to fully address our recommendations. For example, although the instruction requires those responsible for conducting the review to report the results to the systems center's comptroller, the instruction does not require, as we recommended, that cognizant managers, such as department heads, sign a written statement to be provided to the comptroller to confirm that they have performed the required reviews and certify the results of those reviews.

Further, in concurring with our recommendation that SPAWAR compare budgeted to actual orders received from customers and consider these trends in developing budget estimates on orders to be received from customers, DOD did not state how the Navy would ensure that SPAWAR's budget estimates would accurately reflect orders to be received from customers. In its comments, DOD stated that the Navy will continue to refine its budget estimates for customer orders. We believe that the Navy must take additional actions to develop more reliable budget estimates. As noted in our report, reported actual customer orders received exceeded budget estimates from 36 percent to 88 percent during fiscal years 1998 through 2002. For example, for fiscal year 2002, in formulating its budget request, the Navy expected the SPAWAR systems centers to receive about $1.3 billion in customer orders, but the Navy reported that the centers actually received about $2.4 billion in customer orders—a difference of $1.1 billion, or about 88 percent. Having reliable budget estimates on customer orders to be received is critical since this information is used in calculating carryover using DOD's new carryover policy.

DOD partially concurred with our recommendation that it revise its tri-annual review guidance in the DOD Financial Management Regulation to require working capital fund activities to expand their tri-annual reviews to include unobligated balances on customer orders. In its comments, DOD stated that reviewing such balances during the tri-annual reviews was the responsibility of the customer who placed the order with the working capital fund and that the working capital fund activity should work in cooperation with the customer to ensure that unobligated balances are reviewed. We agree that the working capital fund activity should work in conjunction with customers to review unobligated balances. However, as stated in our report, working capital fund activities are in the best position to determine whether unobligated balances are still needed to finance future work. To ensure that unobligated balances are properly reviewed during the tri-annual review process, we continue to recommend that the

DOD Financial Management Regulation be revised to specify the working capital fund activities' role in reviewing unobligated balances on customer orders.

DOD also partially concurred with our recommendation for the SPAWAR systems centers to review all balances related to dormant customer orders in excess of $50,000 during the January and May tri-annual reviews. In its comments, DOD indicated that the current guidance is not clear with regard to whether all such dormant balances over $50,000 are to be reviewed during the specified months. DOD stated that it will review the guidance, as it pertains to working capital fund activities, and make adjustments if appropriate. We agree that DOD's tri-annual review guidance regarding the dollar thresholds for reviewing outstanding commitments and obligations was unclear. We have revised our report accordingly, including the related recommendation, to reflect that DOD's tri-annual review guidance was unclear.

In addition, in the cover letter transmitting its comments on our draft report, DOD took exception to our discussion in the draft report regarding the methodology used by Navy to determine the levels of carryover—reducing the numerator in the carryover formula by the amount of contractual obligations, but not reducing the formula's denominator by the amount of revenue earned from contractual services. Because DOD revised its methodology for calculating carryover in December 2002, DOD commented that such a discussion in the report was irrelevant and confusing to the reader and recommended that it be deleted. We disagree with DOD's comment. Although DOD revised its methodology for calculating carryover, it was not incorporated into Navy's budget submissions until fiscal year 2004. When we undertook this review in July 2002, one of our objectives was to determine if reported carryover accurately reflected the amount of work remaining to be accomplished. As such, this issue was and still is relevant. As stated in this report, our May 2001 report recommended that the revenue used in calculating carryover be adjusted (reduced) for revenue earned for work performed by contractors. Unless this is done, reported carryover will be understated. The Navy did not adjust the revenue amount and, therefore, continued to understate its reported carryover in its budget submissions to the Congress. We continue to believe that this is a reportable issue and have made a related recommendation for DOD to develop and issue written procedures to implement the December 2002 carryover policy. Further, we believe this issue remains of interest to the Congress since the Navy has understated SPAWAR's reported carryover from fiscal year 1998 through fiscal year 2002.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Armed Services; the Subcommittee on Readiness and Management Support, 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; and the Ranking Minority Member, Subcommittee on Defense, House Committee on Appropriations. We are also sending copies to the Secretary of Defense, the Secretary of the Navy, and other interested parties. Copies will be made available to others upon request. Should you or your staff have any questions concerning this report, please contact Gregory D. Kutz, Director, at (202) 512-9505. He can also be reached by E-mail at kutzg@gao.gov.

An additional contact and key contributors to this report are listed in appendix III.

Sincerely yours,

Gregory D. Kutz
Director, Financial Management and Assurance

William M. Solis
Director, Defense Capabilities and Management

Scope and Methodology

To determine if differences existed between the budgeted and reported actual gross carryover and, if so, the reasons for the variances, we obtained and analyzed budget and accounting documents that provided information on budgeted and reported actual gross carryover and orders received from customers from fiscal year 1998 through fiscal year 2002. When variances occurred between the budgeted and reported actual information, we met with accounting and budgeting SPAWAR and Navy headquarters officials to ascertain why there were differences. We also discussed with officials what actions they were taking to develop more reliable budget information on carryover and orders received from customers.

To determine if the reported actual carryover balances reflected the amount of work that remained to be accomplished, we obtained and analyzed the Department of Defense's (DOD) regulations and guidance on carryover. We also obtained and analyzed the SPAWAR systems centers' calculations for the fiscal year 1998 through fiscal year 2002 actual reported year-end carryover balances. We met with officials from SPAWAR and Navy headquarters to discuss the methodology they used to calculate carryover. We (1) obtained explanations about why the Navy made adjustments in calculating the dollar amount of carryover balances as well as the number on months of carryover and (2) determined the impact of those adjustments on the carryover figure. We also reviewed year-end transactions that affected the dollar amount and number of months of carryover. For these year-end transactions, we met with officials from SPAWAR and the two systems centers to determine why these transactions occurred at year-end.

To determine if the Charleston and San Diego SPAWAR Systems Centers have the financial data they need in order to provide reliable data on actual carryover levels to DOD and congressional decision makers, we reviewed the policies and procedures SPAWAR headquarters and the two systems centers have used to implement DOD's tri-annual review guidance. Specifically, we (1) reviewed the DOD, Navy, SPAWAR headquarters, and the two SPAWAR systems centers' tri-annual review guidance and discussed it with cognizant individuals, (2) reviewed the tri-annual review certifications that the two systems centers have submitted since DOD issued its tri-annual review guidance in 1996, and discussed these certifications with cognizant individuals, (3) discussed the systems centers' tri-annual review procedures with cognizant individuals, including those who actually accomplished the reviews, and (4) reviewed documentation on the results of the reviews. We also obtained data on the status of unfilled orders and carryover at the end of fiscal year 2001. Additionally, from these data, we selected and analyzed 34 orders that had outstanding carryover balances at the end of fiscal year 2001 to determine if the carryover balances accurately reflected the amount of work that remained to be performed. We selected orders that (1) were financed with expired appropriations and (2) were unobligated carryover at year-end since these orders were more likely to have unneeded funds and because a review of these orders was, therefore, more likely to identify problems with the systems centers' review procedures.

We performed our work at the headquarters offices of the Under Secretary of Defense (Comptroller) and the Assistant Secretary of the Navy (Financial Management and Comptroller), Washington, D.C.; Space and Naval Warfare Systems Command, San Diego, California; the Charleston Space and Naval Warfare Systems Center, Charleston, South Carolina; and the San Diego Space and Naval Warfare Systems Center, San Diego, California. The reported actual year-end carryover information used in this report was produced from DOD's systems, which have long been reported to generate unreliable data. We did not independently verify this information. The DOD Inspector General has cited deficiencies and internal control weaknesses as major obstacles to the presentation of financial statements that would fairly present the Defense Working Capital Fund's financial position for fiscal years 1993 through 2002.

Our review was performed from July 2002 through June 2003 in accordance with U.S. generally accepted government auditing standards. The Navy provided the budgeting and accounting information referred to in this report. We requested comments on a draft of this report from the Secretary of Defense or his designee. DOD provided written comments, and these comments are presented in the Agency Comments and Our Evaluation section of this report and are reprinted in appendix II.

Comments from the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON DC 20301-1100

JUN 10 2003

COMPTROLLER

Mr. Gregory Kutz, Director, Financial Management and Assurance
Mr. William Solis, Director, Defense Capabilities and Management
U.S. General Accounting Office
Washington D.C. 20548

Dear Mr. Kutz and Mr. Solis:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "NAVY WORKING CAPITAL: Backlog of Funded Work at the Space and Naval Warfare Systems Command Was Consistently Understated," dated May 6, 2003 (GAO Code 192067). I concur with the majority of the recommendations identified in the draft report and am taking action to comply with the recommendations. I partially concur with two of the recommendations as they are currently written both dealing with revisions to existing guidance for performance of the tri-annual review of commitments and obligations. I do agree with the GAO's intent: to ensure that obligations, unobligated balances, and commitments are reviewed regularly to ensure effective use of funds, and to that end will review the guidance to ensure clarity of intent. Additional comments are provided in the enclosure.

See comment 1.

In addition, much of the discussion in the opening sections of the draft report centers on the methodology used by the Space and Naval Warfare Systems Command to determine levels of funded backlog (carryover). This issue was previously addressed in the May 2001 GAO audit *Defense Working Capital Fund: Improvements Needed for Managing the Backlog of Funded Work, GAO-01-559.* While the current report acknowledges that, in response to the May 2001 GAO report, the Department instituted a new analytically based methodology in December 2002. It also includes considerable discussion of the problems and inconsistencies of the old methodology. The draft report makes no recommendations regarding these inconsistencies and the discussion is both irrelevant and misleading in that readers are left with the false impression that carryover levels far exceeded previously acceptable metrics.

Based on the above, I recommend that the draft report be modified to delete the discussion regarding the old carryover methodology, and instead, focus on the new findings associated with yearend funding document modifications and tri-annual reviews.

Sincerely,

for Lawrence J. Lanzillotta

Dov S. Zakheim

Enclosure
As stated

THE GAO DRAFT REPORT DATED MAY 6, 2003
GAO-03-668 (GAO CODE 192067)

"NAVY WORKING CAPITAL FUND: BACKLOG OF FUNDED WORK AT THE SPACE AND NAVAL WARFARE SYSTEM COMMAND WAS CONSISTENTLY UNDERSTATED"

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

Now on p. 30.

RECOMMENDATION 1: The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to determine the extent to which working capital fund activities throughout DoD may be similarly manipulating customer order data at fiscal year end to reduce reported carryover and, if necessary, issue DoD-wide guidance prohibiting this practice as needed. (p. 41/Draft Report)

DOD RESPONSE: Concur.

Now on p. 30.

RECOMMENDATION 2: The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense (Comptroller) to develop and issue written procedures to implement the December 2002 carryover policy. (p. 41/Draft Report)

DOD RESPONSE: Concur. USD(C) provided general guidance in Management Initiative Decision 903 of 3 December 2002. Additional detailed guidance is currently being developed.

Now on p. 30.

RECOMMENDATION 3: The GAO recommended that the Under Secretary of Defense (Comptroller) revise the tri-annual review guidance in the DoD Financial Management Regulation so that working capital fund activities are required to expand the scope of their tri-annual reviews to include unobligated balances on customer orders. (p. 41/Draft Report)

DOD RESPONSE: Partially concur. The existing guidance requires customers, as part of their tri-annual reviews, to validate the orders they have placed with working capital fund activities. We believe they are the responsible office for primary review of the status of their funds. However, we do agree that the working capital fund activity should work in cooperation with the customer to ensure unobligated/unfilled order balances are reviewed prior to expiration of funds as required by Volume 3, Chapter 15, paragraph 1503, of the DoD Financial Management Regulation.

RECOMMENDATION 4: The GAO recommended that the Secretary of Defense direct the Secretary of the Navy to issue guidance to all Navy working capital fund activities, including SPAWAR, that prohibits them from deobligating reimbursable customer orders at fiscal year end and reobligating them in the next fiscal year for the sole purpose of reducing carryover balances that are ultimately reported to Congress. (p. 40/GAO Draft Report)

Now on p. 30.

DOD RESPONSE: Concur.

RECOMMENDATION 5: The GAO recommended that the Secretary of the Navy direct the Commander of Space and Naval Warfare Systems Command to compare budgeted to actual orders received from customers and consider these trends in developing the following year's budget estimates on orders to be received from customers. (p. 41/Draft Report)

Now on p. 30.

See comment 1.

DOD RESPONSE: Concur with comment. As GAO noted, the Navy has already distributed budget guidance detailing the importance of fully reporting working capital fund purchases in customer budgets. While we will continue to refine our estimates it should be noted that appropriated budgets are submitted by line item, and that many line items do not have a consistent historical trend, or for new programs, any history at all. This fact is particularly noticeable in procurement appropriations, where programs rarely have level funding profiles. Similarly, research and development programs are not all constant level-of-effort in nature and therefore offer little in the way of historical trend analysis.

RECOMMENDATION 6: The GAO recommended that the Commander of Space and Naval Warfare Systems Command establish internal control procedures and accountability mechanisms that provide assurance that the systems centers are complying with DoD's tri-annual review guidance. (p. 41/Draft Report)

Now on p. 31.

See comment 1.

DOD RESPONSE: Concur. SPAWAR established GAO's recommended internal control and accountability processes in SPAWARINST 7301.1A, "Tri-Annual Reviews of Commitments and Obligations," issued 9 October 2002.

RECOMMENDATION 7: The GAO recommended that the Commander of Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers to maintain documentation that shows who conducted the tri-annual reviews so that these individuals can be held accountable for the reviews. (p. 42/Draft Report)

Now on p. 31.

DOD RESPONSE: Concur. See Response 6.

RECOMMENDATION 8: The GAO recommended that the Commander of Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers to maintain documentation that identifies (1) any additional research or corrective action that is required as a result of the tri-annual reviews and (2) who is responsible for taking the action. (p. 42/Draft Report)

Now on p. 31.

DOD RESPONSE: Concur. See Response 6.

RECOMMENDATION 9: The GAO recommended that the Commander of Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers to require cognizant managers, such as department heads, to confirm in writing that they have (1) performed the required tri-annual reviews and (2) completed the related follow-up actions by signing a statement, such as the draft certification statement developed by Charleston Systems Center Comptroller, that describes the specific tasks that were accomplished and provide this statement to the systems center comptroller. (p. 42/Draft Report)

Now on p. 31.

DOD RESPONSE: Concur. See Response 6.

RECOMMENDATION 10: The GAO recommended that the Commander of Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers develop and implement internal control procedures to provide assurance that tri-annual reviews of individual commitment, obligation, and accrued expenditure balances are adequate. (p. 42/Draft Report)

Now on p. 31.

DOD RESPONSE: Concur. See Response 6.

RECOMMENDATION 11: The GAO recommended that the Commander of Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers develop policies and procedures to capture the information on tri-annual review results, such as the amount of obligation reviewed, confirmed, and revised, that they are required to report to SPAWAR headquarters and the SPAWAR headquarters, in turn, is required to report to navy headquarters. (p. 42/Draft Report)

Now on p. 31.

DOD RESPONSE: Concur. See Response 6.

See comment 2.

Now on p. 30.

RECOMMENDATION 12: The GAO recommended that the Commander of Space and Naval Warfare Systems Command direct the Commanders of the Charleston and San Diego SPAWAR Systems Centers to review all dormant customer order-related balances in excess of $50,000 during the January and May tri-annual reviews as currently required. (p. 43/Draft Report)

See comment 2.

DOD RESPONSE: Partially concur. In subsequent discussions with GAO it was determined that the basis for the recommendation was to ensure that SPAWAR was in compliance with guidance provided in the DoD Financial Management Regulation Volume 3, Chapter 8, Section 0804. Current guidance requires the following reviews as part of the tri-annual review: (1) outstanding commitments and unliquidated obligations $200,000 or greater for the **capital** budget of the working capital fund activities, and (2) outstanding commitments and unliquidated obligations $50,000 or greater for the **operating** portion of the working capital fund. The definitions of what is included in the operating portion, whether it pertains to the pure working capital fund operating cost, or whether the reimbursable customer orders (many of which are funded using RDT&E and investment funds) are to be included in this review needs to be examined further. The Department will review the current guidance, specifically as it pertains to the working capital fund activities, and will make adjustments if appropriate.

Now on p. 32.

RECOMMENDATION 13: The GAO recommended that the Commander, SPAWAR Systems Center, San Diego direct the Center Comptroller to develop and implement a methodology for identifying and analyzing accrued expenditure balances. (p. 43/Draft Report)

DOD RESPONSE: Concur. SPAWAR Systems Center, San Diego is currently developing the required methodology and plans to implement the recommendation by 30 Dec 2003.

Now on p. 32.

RECOMMENDATION 14: The GAO recommended that the Commander, SPAWAR Systems Center, San Diego direct the Center Comptroller to identify dormant commitments, obligations, and accrued expenditures in the tri-annual review computer listings that are provided to the technical departments. (p. 43/Draft Report)

DOD RESPONSE: Concur. See Response 6.

The following are GAO's comments on the Department of Defense's (DOD) letter dated June 10, 2003.

GAO Comments

1. See the Agency Comments and Our Evaluation section of this report.

2. As discussed in the Agency Comments and Our Evaluation section of this report, we have modified this recommendation and the related section of the report in response to DOD's comment.

GAO Contact and Staff Acknowledgments

GAO Contact

Greg Pugnetti, (703) 695-6922

Acknowledgments

Staff who made key contributions to this report were Francine DelVecchio, Karl Gustafson, William Hill, Christopher Rice, Ron Tobias, and Eddie Uyekawa.

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