United States General Accounting Office

GAO

Report to the Chairman, Committee on Government Reform and Oversight, House of Representatives

November 1996

BUDGET ISSUES

Budgeting for Federal Capital

G A O

75 years 1921 - 1996

GAO/AIMD-97-5

GAO

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

Accounting and Information
Management Division

B-261817

November 12, 1996

The Honorable William F. Clinger, Jr.
Chairman, Committee on
Government Reform and Oversight
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we review how five federal organizations—the Army Corps of Engineers, the Coast Guard, the Interagency Fleet Management System and Public Buildings Service of the General Services Administration, and the U.S. Geological Survey—plan and budget for fixed assets. Specifically, we examined (1) how these organizations perceive the current budget process affects their capital acquisitions and (2) whether there are funding mechanisms, used or proposed by these organizations, that might be helpful in planning and budgeting for fixed assets. In addition, we agreed to examine the responses to the Office of Management and Budget's Bulletin 94-08, "Planning and Budgeting for the Acquisition of Fixed Assets." We have included a matter for congressional consideration and are making recommendations to the Director of the Office of Management and Budget to continue to improve fixed-asset planning and budgeting.

We are sending copies of this report to the Ranking Minority Member of your Committee, the Director of the Office of Management and Budget, and to interested congressional committees. We will also make copies available to others upon request. The major contributors to this report are listed in appendix VII. If you have any questions concerning this report, please call me on (202) 512-9573.

Sincerely yours,

Paul L. Posner
Director, Budget Issues

Executive Summary

Purpose

As federal agencies find themselves under increasing budgetary constraints and increasing demands to improve service, the importance of making the most effective fixed asset acquisitions grows. Fixed assets often require large amounts of resources up front but can generate long-term efficiencies and savings. Prudent capital planning can help agencies to make the most of limited resources while failure to make timely and effective capital acquisitions can result in increased long-term costs.

However, making such capital acquisitions can present challenges. To maintain control over expenditures, the Congress generally requires that agencies have budget authority for the full cost of a capital acquisition at the time the acquisition is undertaken—regardless of when the benefits or outlays occur. Because an agency or program generally must absorb the entire cost of these relatively expensive acquisitions in a single year's budget, fixed assets may seem prohibitively expensive despite their long-term benefits. Moreover, when capital costs are not allocated to programs using these fixed assets, valuable information about total annual program costs may not be considered when budget decisions are made. Such information can help ensure that appropriate trade-offs are made between capital and operating inputs.

Some have proposed that the challenges agencies face in budgeting for fixed assets—and other spending with long-term benefits—can be corrected by adopting a separate capital budget.[1] Yet, others believe that a separate capital budget would potentially lead to greater problems by weakening longstanding budgetary controls and reducing spending discipline.

Representative William F. Clinger Jr., Chairman of the House Committee on Government Reform and Oversight, asked GAO to examine strategies that might address concerns about a potential bias against capital while preserving the fiscal discipline provided by the current unified budget structure. To identify these strategies, GAO examined how selected federal agencies plan and budget for capital assets (assets that agencies use in their own operations). The five case study organizations represented by four agencies are: the Army Corps of Engineers, the Coast Guard, the General Services Administration's (GSA) Interagency Fleet Management System (IFMS) and Public Buildings Service (PBS), and the U.S. Geological

[1]Although capital budgeting proposals vary, many require that spending on assets with long-term benefits to the agency be recorded in a separate capital budget. The full cost of each asset would be recorded in the operating budget over a period of years through a depreciation charge.

Survey (USGS).[2] Specifically, GAO evaluated (1) how these case studies perceive the current budget process affects their ability to make effective capital acquisitions; (2) whether there are funding mechanisms, used or proposed by these organizations, that might be helpful in planning and budgeting for capital assets within the current budgeting framework established by various budget and appropriations laws; and (3) the results of the Office of Management and Budget's (OMB) Bulletin 94-08, "Planning and Budgeting for the Acquisition of Fixed Assets".

Background

Federal spending on physical assets can be divided into two categories: that which provides benefits to the government's own operations and that which provides long-term benefits to the nation as a whole. This report focuses on the former—those physical assets that the federal government uses primarily to deliver federal services—and refers to them interchangeably as "fixed assets" or "capital assets." Federal office buildings, equipment, and information technology are examples of these. Like many other physical assets, they have relatively high initial costs but are intended to yield benefits over many years. An earlier report addressed budgeting for physical assets, such as infrastructure, as well as intangible assets, such as research and development and human capital, that have the potential to increase the long-term productive capacity of our broader economy.[3]

Federal organizations acquire capital assets in an environment of resource constraints and budgetary controls. Spending for most capital assets as well as much of government's operations is categorized by the Budget Enforcement Act of 1990 (BEA) as discretionary, and thus subject to an annual governmentwide cap on discretionary spending.[4] The sum of

[2]A description of GAO's criteria for selecting case studies appears in the Objectives, Scope, and Methodology section of Chapter 1. This report also provides limited, supplementary information on four additional organizations—the Food and Drug Administration (FDA), the Forest Service, the General Services Administration's Information Technology Service (ITS), and the National Oceanic and Atmospheric Administration (NOAA).

[3]In Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993), investment was defined as spending that is intended to increase the long-term productivity of the private sector. Investment spending is comprised of a subset of the government's total spending on physical assets, as well as some federal spending on intangible assets such as the conduct of research and development. Physical assets that would typically meet our definition of investment include highways, dams, and the air traffic control system. In Federal Budget: Choosing Public Investment Programs (GAO/AIMD-93-25, July 23, 1993), GAO described ways to distinguish between productivity-enhancing programs and spending programs with other goals such as stimulating or redistributing economic activity. This definition of investment differs from a common definition in which investment is any spending designed to generate long-term benefits.

[4]These caps were established by BEA and have been proposed to be extended to 2002.

agencies' discretionary budgets must remain within these caps, which generally have been declining since 1991. Additionally, for over 100 years, the Adequacy of Appropriations Act and the Antideficiency Act have required agencies to have budget authority (or to budget) for the full cost of most capital assets before acquiring them (referred to as up-front funding). The Congress imposes other controls, such as limits on the length of time and purpose for which funds can be used, to help ensure that agencies effectively use funds to meet congressional priorities.

Spending caps, up-front funding requirements, and the way budget authority and outlays are recorded in the budget were intended to help the Congress control the overall level of federal spending and recognize the full budgetary impact of commitments when they are made. Up-front funding requires that budget authority for the full price of capital acquisitions be provided before the asset is acquired, regardless of when obligations are made or benefits actually accrue. This ensures that the full costs of capital projects are recognized at the time that the commitment is made to undertake them. In an environment of capped resources, however, up-front funding can make capital acquisitions seem prohibitively expensive in the budget year and, some have suggested, can create a bias against capital in budget deliberations.

Some budget practitioners have advocated that the federal government adopt a capital budget to spread capital costs over the life of an asset through depreciation. However, GAO has noted that, unless the full amount of budget authority is required to be available up front, the ability to control decisions when total resources are committed to a particular use is reduced.[5] Thus, a capital budget, in which only annual depreciation would be appropriated, would lessen budgetary control under the federal government's obligations-based budgeting system.

This report discusses how the seemingly contradictory goals of congressional control and managerial flexibility can be reconciled within the current unified budget structure. The strategies described in this report are not exhaustive of those that could be useful to agencies. Rather they represent a few of the ways in which some agencies have attempted to adapt to their budget environment.

This report does not present a final or universal solution to the problems in budgeting for capital assets. Indeed, there are broader issues, generally

[5]Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993).

beyond the scope of this report, that must also be considered if the capital acquisition process is to be improved. For example, the selection and evaluation of capital projects must be improved. GAO's past work has identified a variety of federal capital projects, including information technology as well as large-scale construction projects, where acquisitions have yielded poor results—costing more than anticipated, falling behind schedule, and failing to meet mission needs.[6] Recent legislation seeks to prevent such results. The Federal Acquisition Streamlining Act of 1994 (FASA) requires agencies to develop cost, schedule, and performance goals for their acquisitions and requires OMB to report to the Congress on agencies' progress in meeting these goals.

Although the federal government's cash-based budget and up-front funding requirement have long provided fiscal control, they result in budgetary costs that differ from the measurement of full, annual program costs that will be needed to successfully execute the Government Performance and Results Act of 1993 (GPRA). Under GPRA, agencies must develop, no later than by the end of fiscal year 1997, strategic plans that cover a period of at least 5 years and include the agency's mission statement; identify the agency's long-term strategic goals; and describe how the agency intends to achieve those goals through its activities and through its human, capital, information, and other resources. GPRA also requires each agency to submit to OMB, beginning for fiscal year 1999, an annual performance plan.[7] In essence, the annual performance plan is to contain the annual performance goals the agency will use to gauge its progress toward accomplishing its strategic goals and identify the performance measures the agency will use to assess its progress. To effectively evaluate program performance, agencies will need data on the full, annual costs of programs, including capital usage. Therefore, GPRA's requirements may drive changes in the budget account structure and other elements of the budget process that have traditionally been geared more toward providing fiscal control than measuring full program costs.

Results in Brief

Requiring that budget authority for the full cost of acquisitions be provided before an acquisition is made allows the Congress to control capital spending at the time a commitment is made and to better understand the future economic impact of its decisions. However, officials of most of our

[6]See for example Managing for Results: Steps for Strengthening Federal Management (GAO/T-GGD/AIMD-95-158, May 9, 1995); Space Station: Program Instability and Cost Growth Continue Pending Redesign (GAO/NSIAD-93-187, May 18, 1993); and Fossil Fuels: Improvements Needed in DOE's Clean Coal Technology Program (GAO/RCED-92-17, October 30, 1991).

[7]The first annual performance plans are to be submitted in the fall of 1997.

case studies see up-front funding as problematic because it requires the full cost of an asset to be absorbed in the annual budget of an agency or program, despite the fact that benefits may accrue over many years. Thus, when combined with the effect of discretionary spending caps on agency and program budgets, the up-front funding requirement can make capital acquisitions seem prohibitively expensive.

Although some have recommended that the government adopt a full-scale capital budget, this raises major budget control issues and may not be necessary to address agency-identified impediments to capital spending. Several strategies are available that can reduce the impact of the full funding requirement on agency budgets and help agencies accommodate the consistent application of up-front funding within the current budget structure. Some strategies—such as budgeting for stand-alone stages of capital acquisitions and using a revolving fund or an investment component in a working capital fund—may permit agencies to plan and manage their capital spending within an environment of full up-front funding and without the loss of budgetary control that would accompany a separate capital budget. In addition, revolving funds can also help to make managers accountable for the full costs of their programs including capital usage.

Each of our case studies used one or more of these strategies to help mitigate the spikes in budget requests that up-front funding can produce. The Coast Guard reduces the budget authority needed to comply with up-front funding in a given year by dividing capital acquisitions into stand-alone stages[8] that can be funded separately. Another strategy that the Congress has provided to accommodate up-front funding is to authorize agencies to accumulate budget authority for capital purchases over time. PBS, IFMS, the Corps of Engineers, and USGS use a revolving fund to charge users for and accumulate the cost of asset replacement, asset improvements, and/or new acquisitions over a period of years. As a result, capital costs are included in program budgets. Similarly, the Congress recently provided USGS with authority to establish an expanded investment component in its working capital fund that allows managers that comply with specified requirements to regularly set aside and save annual appropriations for future purchases of expensive equipment.

Our case studies have been able to use these and other tools to adapt to other perceived impediments. For example, revolving funds, budgeting for

[8]A stand-alone stage is a unit of a capital project that can be economically or programmatically useful even if the entire project is not completed.

stand-alone stages, and reprogramming authority help case studies respond to changing missions and funding uncertainty. Some case studies use or have sought accounts dedicated to capital acquisition to highlight their capital needs and prevent the "crowding out" of capital spending. Still others have sought additional authority from the Congress, such as the retention of proceeds from the sale of capital assets.

The Congress is continually challenged to find an appropriate balance between managerial flexibility and congressional control. Each of the strategies that our case studies use has different strengths and weaknesses in this regard, and they may not be appropriate for all agencies or in all circumstances. For example, contracting out allows agencies to use an asset without budgeting for its full cost up-front but should only be used when contracting out is more cost-effective than purchasing an asset. Similarly, agencies that retain proceeds from the sale of assets have an incentive to dispose of uneconomical assets, but agencies and the Congress must adequately oversee asset sales to determine whether a sale is appropriate and how the proceeds should be used. Revolving funds can help agencies accumulate the resources needed to make capital acquisitions over time but should only be established when agencies have a record of sound financial management and when fund purchases are small and routine enough to warrant reduced scrutiny by the Congress and OMB.

Some of the problems and strategies identified by our review also surfaced as a result of OMB's effort to improve agencies' planning and budgeting for fixed assets. OMB used the responses from Bulletin 94-08 in its first ever Director's review[9] focusing on fixed assets. Among other findings, the review identified the full extent to which capital projects were not fully funded up front. A follow-up bulletin and Director's review helped OMB identify more instances of such "incremental" funding.[10] They also encouraged agencies to include full up-front funding for capital projects in their budget requests. As a result, OMB requested $1.4 billion in the fiscal year 1997 budget to fully fund some of these projects as an initial step toward requesting full up-front funding for all capital projects.[11] New

[9]The Director's review is a formal discussion with the OMB Director of recommendations developed by OMB examiners.

[10]Incremental funding occurs when the Congress provides funds for a capital acquisition based on the obligations estimated to be incurred within a fiscal year although such funds alone will not produce a usable asset.

[11]Only a small portion of this request was ultimately approved in fiscal year 1997 appropriations actions.

budget preparation instructions for fiscal year 1998 require agencies to request full up-front funding for stand-alone stages of all ongoing and new fixed-asset acquisitions.

Principal Findings

The Proportion of Governmentwide Spending on Capital Has Changed Little From Its 1970 Level

Despite growing budgetary constraints, spending to acquire nondefense physical assets (a broader category of assets that includes dams and environmental restoration in addition to capital assets used in agency operations) is basically unchanged from 25 years ago relative to gross domestic product (GDP) and total federal outlays.[12] In 1995, federal spending for these assets totaled $19.5 billion. This represents about the same proportion of GDP (0.3 percent) and of total federal outlays (1.3 percent) as it did in 1970. Among our case studies, capital spending trends varied.[13] IFMS and PBS generally experienced increases in capital obligations relative to total obligations between 1982 and 1995. USGS and the Corps saw variations in capital spending relative to other spending between 1982 and 1995 while the ratio of capital to total outlays for the Coast Guard has steadily declined.

Although spending trends indicate the magnitude of capital acquisitions, trends cannot answer the question of whether there is a bias for or against capital. Spending increases or decreases are the result of a combination of decisions about relative needs within and between agencies. Moreover, data on the magnitude of spending masks important information about the relative effectiveness and mix of capital assets from year to year. Improvements in technology or the selection of more effective capital assets could reduce the amount an agency needs to spend on capital assets in order to achieve its goals.

[12]This broader category is used because limitations of the data sources on federal capital spending prevent analysis of trends in spending for capital assets as defined in this report.

[13]Due to data limitations, capital spending could not be quantified using a single or precise measure. Therefore, data measured in outlays or obligations—depending on which data were available—were used, but the term capital spending is used to refer to both for simplicity. Each of these data sources may also include spending for some assets that do not meet our definition of capital assets. As a result, figures should be seen as illustrative only.

Balance Between Managerial Flexibility and Congressional Control Needed for Effective Capital Acquisitions

Case studies used several strategies to adapt to the requirement to fully fund capital acquisitions up front. Each of the methods has advantages, disadvantages, and conditions necessary to its use, but some may be worthwhile for other agencies to consider. The methods demonstrate a range of balance between managerial flexibility and congressional control. These strategies include:

- budgeting for stand-alone stages of a larger project,
- using a revolving fund,
- using an investment component within a working capital fund,
- sharing assets, and
- contracting out for capital-intensive services.

The Coast Guard sometimes divides capital acquisitions into stand-alone stages and requests full funding for each stage over a period of years. For example, when acquiring a class of ships, the Coast Guard may divide the acquisition into a contract for a lead ship and spare parts with options to buy a portion of the remaining fleet in each succeeding year. This limits the Coast Guard's annual commitment, and thus its annual need for budget authority. It also ensures that the agency receives something useful from each commitment; this differentiates budgeting for stand-alone stages from incremental funding in which a single useful asset is funded by appropriations made in 2 or more years.

PBS, IFMS, and the Corps use revolving funds to accumulate over a period of years the resources needed for up-front funding. By charging users for the cost to replace and maintain capital assets, revolving funds help ensure that needed funds will be available for capital acquisition and that program budgets reflect capital as well as operating costs. Such budgets can be useful in assessing cost and performance as required by GPRA. However, revolving funds are only appropriate if an agency has an established record of good financial management and controls and has developed capital plans that can be used for oversight. Because revolving fund purchases need not be reviewed by the Congress or OMB, traditional revolving funds may not be appropriate when competition for the fund's services is lacking and when purchases are relatively large-scale, sporadic, or heterogeneous. Under these conditions, a greater degree of oversight is warranted to ensure that the resources accumulated in the fund are used where most needed governmentwide. Revolving funds may also not be appropriate capital financing mechanisms for all agencies due to the incentives they create. For example, Coast Guard officials believe that charging capital asset users may create incentives to underuse assets,

including those for search and rescue, and that capital costs could be difficult to assign accurately given the agency's overlapping missions. Certain other conditions, discussed in chapter 3, should also be present to ensure the effective and appropriate use of revolving funds.

USGS' investment component in its working capital fund achieves many of the same goals sought by revolving funds. USGS recently received expanded authority to contribute some annual appropriations into its working capital fund in order to save for expensive equipment purchases. This authority gives USGS managers an incentive to save some otherwise annually expiring funds for future capital needs and may be a promising strategy for other organizations with 1-year appropriations. However, investment components should be accompanied by detailed investment plans to ensure that their funds are spent as the Congress intended.

USGS limits the amount of budget authority needed for capital acquisitions by sharing the purchase and use of assets with external entities, and the Corps contracts out for capital-intensive work when officials believe it is economically justified. Sharing assets and contracting out can be useful and cost-effective for the government when agencies do not need full use of an asset or when asset needs are short-term and non-recurring. However, contracting out can be misused to by-pass budget scoring rules for purchases. When this occurs, the long-term cost of contracting out can be higher than directly purchasing the asset.

Some case studies propose additional strategies to help manage up-front funding. These strategies include borrowing from the Treasury using agency assets as collateral, joining private real estate developers in equity partnerships, and guaranteeing developers' loans. However, some of these strategies could diminish congressional control by creating budget authority outside of the appropriations process. Also, because the budget scoring of some of these strategies is still under review, it is not clear that agencies would in fact be better able to accommodate up-front funding.

Like up-front funding, other features of the budget process necessary for congressional control are perceived by agencies as impediments to their ability to make effective capital acquisitions. For example, uncertainty over future funding levels is a feature of the budget process that results from the Congress' need to be responsive to changing national priorities. However, some long-term capital projects, like construction, need some degree of funding certainty to be planned and managed effectively. Similarly, the Congress cannot uniformly provide agencies with flexible

account features and the ability to retain proceeds from asset sales if it is to adequately control how taxpayers' funds are used. However, case studies with more flexible funding mechanisms seem to have fewer impediments in making capital acquisitions.

Our case studies use a variety of strategies to mitigate adverse effects of funding and mission uncertainty on capital acquisition. At IFMS and the Corps, revolving fund managers set charges such that users contribute to their assets' replacement cost over the assets' useful lives. As a result, these managers have some assurance that, as long as contributions are made in accordance with usage, funds will be available to modernize or replace the asset if needed or to meet other asset needs that arise. The Corps and the Coast Guard use reprogramming authority to make limited adjustments in funding of existing projects when there are unexpected changes in cost. Similarly, the Coast Guard's practice of budgeting for stand-alone stages of larger projects gives the agency and the Congress flexibility to change course based on how well the acquisition is progressing and the urgency of other needs.

Case studies compensated for account features that seem to reduce their ability to justify capital expenditures by seeking different features or improving budget justifications. When a capital expenditure is funded from an account comprised predominantly of operating expenditures, the account's high spend-out rate[14] may discourage capital spending. Such an account can also obscure capital needs that are buried within a larger amount of operating spending. To combat these problems, USGS tailored budget justifications to highlight capital needs, while PBS requested a separate appropriations account for new capital acquisitions that would increase its asset base. The length of availability of capital funding was also problematic for some case studies. Through the use of revolving funds, investment components, and multiyear appropriations, all case studies now have the ability to fund capital assets with multiyear or no-year funds. Case studies believe that this feature helps accommodate the size and scope of capital projects. However, the Coast Guard has found that its multiyear funding is of inadequate length in some instances. Even with adequate fund availability and other account features, case studies find that capital spending for major renovations or repairs are more challenging to justify than spending for new facilities.

[14]A spend-out or outlay rate is the ratio of outlays resulting from new budgetary resources to the new budgetary resources in a given fiscal year.

The Congress permits some of our case studies, such as the Corps and IFMS, to retain the proceeds from capital asset sales for the purpose of replacing and maintaining assets. Other case studies, including the Coast Guard and PBS, would like to have this authority. Coast Guard and PBS officials believe that the ability to keep proceeds would provide greater incentive to dispose of less economical properties and enable reinvestment in other needed assets. However, to maintain fiscal control and authority over priorities, the Congress has granted such retention authority cautiously. Although PBS has not been permitted by the Congress to retain proceeds, the Coast Guard received congressional authority to retain proceeds from surplus real property sales and from the sale of certain aircraft in fiscal year 1997. Recently enacted legislation extends this authority to Coast Guard housing.

Although most of the strategies case studies use or propose to improve their ability to acquire capital assets require some trade-off between agency flexibility and congressional control, some improvements can be made without altering this balance. For example, agencies and the Congress can together determine whether operating expenditures can be cut to make resources available for capital. Agencies can increase the likelihood that capital acquisitions will receive appropriate consideration by improving the planning of and budget justifications for capital acquisitions. By anticipating future needs, agencies may be able to schedule projects to alleviate resource spikes. Agency managers can use explicit decision criteria and quantifiable measures for assessing mission benefits, risks, and costs to identify early—and avoid—investments in projects with low potential to yield significant improvements in performance.[15]

OMB's Effort to Examine Asset Planning Is Still Evolving

OMB Bulletins 94-08 and 95-03 on "Planning and Budgeting for the Acquisition of Fixed Assets" required agencies to submit 5-year capital spending plans with accompanying justification and encouraged them to consider the use of flexible funding mechanisms to meet needs within the current budget rules. OMB officials stated that Bulletin 94-08 was intended to be a first step in an ongoing effort to improve capital decision-making. OMB received responses from most agencies it expected would meet the bulletin's reporting threshold although the submissions varied in their comprehensiveness. Nevertheless, OMB was able to use agency responses to the Bulletin in its first ever Director's Review on acquisition of fixed

[15]Information Technology Investment: A Governmentwide Overview (GAO/AIMD-95-208, July 31, 1995).

assets. The Review covered the use of flexible funding mechanisms, the extent to which full up-front funding was being practiced, and the degree to which agencies had difficulties in justifying capital needs that required "spikes" in funding. Full up-front funding was a particular concern to OMB, and the review documented the extent to which it had been neither requested by agencies nor provided by the Congress for all capital projects. Some projects at the Corps of Engineers, the National Aeronautics and Space Administration (NASA), the Department of Energy (DOE), and the Bureau of Reclamation were incrementally funded. A follow-up bulletin (Bulletin 95-03) and Director's review of fixed assets helped OMB isolate incidents of incremental funding and encouraged agencies to request full up-front funding for their capital projects.

OMB used the results of these bulletins to begin estimating the cost of fully funding projects that are currently being funded incrementally and to develop guidance on planning and analyzing fixed asset acquisitions. In the President's fiscal year 1997 budget, OMB requested $1.4 billion in budget authority to fully fund some ongoing projects at DOE and NASA that have been incrementally funded.[16] It also reported a fiscal year 1997 cost of $23 billion to fully fund ongoing and new capital projects at the Corps of Engineers and the Bureau of Reclamation. In the summer of 1996, OMB supplemented its annual budget preparation instructions with a new Part 3 of Circular A-11 providing guidance to agencies on planning and analyzing fixed asset acquisitions. Part 3 requires agencies to request full up-front funding for stand-alone stages of all ongoing and new fixed asset acquisitions and outlines broad principles for planning and monitoring such acquisitions. It also requires agencies to consider how their fixed asset plans relate to the plans currently being developed for performance-related initiatives, such as GPRA, and to develop baseline cost, schedule, and performance goals for fixed asset acquisitions. These goals are to be the standard against which actual work will be measured. Variances from the goals will be reported to the Congress as required by FASA.

The implications of fully funding capital projects—including those that have been incrementally funded—will be clarified for the government as a whole when agencies submit their fiscal year 1998 budget requests to OMB. The principal effect will be to increase budget authority in the initial year for projects that would otherwise be incrementally funded over a period of years. Because projects' cash flows would generally be unaffected by the

[16]Only a small portion of this request was ultimately approved in fiscal year 1997 appropriations actions.

application of up-front funding, the government's total annual outlays should not change for a given level of capital projects. For the longer term, the impact of such a shift on future years' budget authority will be a function of whether policymakers change the number or types of capital acquisitions in response to the up-front funding requirement.

Recommendations to the Office of Management and Budget

GAO recommends that the Director of the Office of Management and Budget continue OMB's top-level focus on fixed asset acquisitions to include working with agencies and the Congress to promote flexible budgetary mechanisms that help agencies accommodate the consistent application of up-front funding requirements while maintaining opportunities for appropriate congressional oversight and control.

As OMB continues to integrate GPRA requirements into the budget process, GAO recommends that the Director of the Office of Management and Budget, ensure that agencies' capital plans flow from and are based upon their strategic and annual performance plans. In addition, OMB should continue its efforts to ensure that cost, schedule, and performance goals are monitored as required by FASA.

Matter for Congressional Consideration

Although requiring that budget authority for the full cost of acquisitions be provided before an acquisition is made allows the Congress to control capital spending at the time a commitment is made, it also presents challenges. Because the entire cost for these relatively expensive acquisitions must be absorbed in the annual budget of an agency or program, fixed assets may seem prohibitively expensive despite their long-term benefits.

This report describes some strategies that a number of agencies have used to manage this dilemma. The Congress should consider enabling agencies to use more flexible budgeting mechanisms that accommodate up-front funding over the longer term while providing appropriate oversight and control. For agencies having proven financial management and capital planning capabilities and relatively small and ongoing capital needs, these techniques could include revolving funds and investment components. Such techniques enable agencies to accumulate resources over a period of years in order to finance certain capital needs, promote full costing of programs and activities by including costs related to capital usage in program budgets, and provide a degree of funding predictability to aid in long-range planning. As GPRA moves toward full implementation, these and

other tools may take on increasing importance in helping managers and the Congress to identify program costs and to more efficiently manage capital assets.

Agency Comments

Officials from our case studies and OMB agreed with this report's conclusions and recommendations. They also provided technical corrections which have been incorporated in this report where appropriate. In commenting on a draft of this report, OMB and GSA officials raised issues which required clarification and elaboration in some sections of the report. OMB officials agreed with the report's support for up-front funding of capital assets but expressed concern that the use of intragovernmental revolving funds to fund capital acquisitions in some circumstances would undermine the up-front funding principle and reduce budgetary control. To clarify that revolving funds are not always appropriate for making capital acquisitions, references were added throughout the report to indicate their appropriateness for relatively small and ongoing capital needs. GSA officials expressed a desire for some discussion of proposed changes in scoring operating leases. Reference to previous GAO testimony on this matter was added in chapter 3. GSA officials also expressed their belief that congressional control could be maintained if the FBF retained proceeds from the disposal of PBS properties. The officials suggested that, because all funds deposited in the FBF must now be appropriated before use, the Congress would have an opportunity to determine how disposal proceeds should be used. This report provides observations on circumstances which affect whether agencies should retain proceeds, such as the need to provide a constant level of services. It was not intended to address whether such circumstances exist in any specific agency. Each agency's situation would need to be assessed individually to select the appropriate financing mechanism and to determine how to handle disposal proceeds. Therefore, the report was not altered to address this comment.

Contents

Executive Summary		2
Chapter 1 Introduction		20
	Capital Decisions Are Made in an Environment of Resource Constraints	21
	Capital Spending Has Been Relatively Constant Over Time	22
	Private Sector and Federal Practices for Budgeting for Capital Differ	27
	Federal Spending Is Guided by Budgetary Controls	28
	The Nature of This Report	30
	Objectives, Scope, and Methodology	31
Chapter 2 Agency and Governmentwide Perspectives on Up-Front Funding Differ		34
	Agencies View Up-Front Funding as an Impediment to Capital Acquisition	34
	Up-Front Funding Is Paramount to Governmentwide Fiscal Control	36
	A Few Agencies Have Been Exempt From Up-Front Funding	38
Chapter 3 Up-Front Funding Can Be Accommodated by Balancing Managerial Flexibility and Congressional Control		41
	Budgeting for Stand-Alone Stages of an Acquisition Limits the Budget Authority Needed	41
	Revolving Funds Can Be Effective in Spreading the Cost of Capital Acquisition Over Time and Incorporating Capital Costs Into Operating Budgets	43
	An Investment Component Encourages Saving for Capital Needs	50
	Agencies Can Reduce Their Need to Own Assets	53
	Operating Leases Offer Flexibility but Can Be More Costly	54
	Case Studies Seek Additional Tools for Responding to Up-Front Funding	57

Chapter 4 Certain Mechanisms Enabled Case Studies to Deal With Other Capital Spending Impediments

61
Case Studies Find Various Tools Useful for Managing Changes in Missions and Funding Levels 61
Account Features Affect How Trade-Offs Between Capital and Other Expenditures Are Made 64
Asset Sales Questions Pit Managerial Autonomy Against Congressional Control 69

Chapter 5 OMB's Effort to Improve Planning and Budgeting for Fixed Assets

72
Agency Restructuring and Increasingly Limited Resources Prompted Review of Planning and Budgeting for Fixed Assets 72
Completeness of Bulletin Responses Varied 73
Two Agencies Discussed Funding Mechanisms for Fixed Assets 74
Case Studies Found Bulletin's Requirements Easy to Meet With Previously Reported Data 74
Bulletin Responses Helped Identify Problems With Planning and Budgeting for Fixed Assets as Well as Mitigating Strategies 75
OMB's Second-Year Effort Results in a Proposal to Expand the Use of Full Funding 76
OMB's Third-Year Effort Attempts to Link Fixed-Asset Planning and Budgeting With Performance Initiatives 78

Chapter 6 Observations and Conclusions

80
The Budget Process Should Encourage Prudent Capital Decisions 80
Agencies and the Congress Must Work Together to Find Tools That Encourage Prudent Capital Decisions 81
Recommendations to the Office of Management and Budget 84
Matter for Congressional Consideration 84
Agency Comments and Our Evaluation 85

Appendixes

Appendix I: Comparison of Case Studies and Other Organizations Contacted 88
Appendix II: The Coast Guard 93
Appendix III: U.S. Army Corps of Engineers 97
Appendix IV: The Interagency Fleet Management System 103
Appendix V: The Public Buildings Service 108
Appendix VI: The U.S. Geological Survey 115
Appendix VII: Major Contributors to This Report 119

Tables

Table 1.1: Examples of Assets Acquired and Accounts Used to Finance Capital by Case Studies 33
Table I.1: Comparison of Case Studies and Other Organizations Contacted 90

Figures

Figure 1.1: Direct Nondefense Physical Capital Outlays as a Percent of GDP 24
Figure 1.2: Direct Nondefense Physical Capital Outlays as a Percent of Total Federal Outlays 25
Figure 1.3: Direct Nondefense Physical Capital Outlays as a Percent of Domestic Discretionary Outlays 26
Figure II.1: Coast Guard Capital and Operating Outlays for Fiscal Years 1982 Through 1995 94
Figure II.2: Coast Guard Capital Outlays as a Percent of Total Outlays for Fiscal Years 1982 Through 1995 95
Figure III.1: Corps Capital and Operating Outlays for Fiscal Years 1982 Through 1995 98
Figure III.2: Corps Capital Outlays as a Percent of Total Outlays for Fiscal Years 1982 Through 1995 99
Figure IV.1: IFMS Capital and Operating Obligations for Fiscal Years 1982 Through 1995 104
Figure IV.2: IFMS Capital Obligations as a Percent of Total Obligations for Fiscal Years 1982 Through 1995 105
Figure V.1: PBS Capital and Operating Obligations for Fiscal Years 1982 Through 1995 109
Figure V.2: PBS Capital Obligations as a Percent of Total Obligations for Fiscal Years 1982 Through 1995 110
Figure V.3: PBS Obligations for Construction, Repairs and Alterations, and Rental of Space from Fiscal Years 1982 Through 1995 111
Figure VI.1: USGS Capital and Operating Obligations for Fiscal Years 1982 Through 1995 116
Figure VI.2: USGS Capital Obligations as a Percent of Total Obligations for Fiscal Years 1982 Through 1995 117

Abbreviations

AC&I	acquisitions, construction, and improvements
BEA	Budget Enforcement Act
CBO	Congressional Budget Office
CIP	capital investment plan
DOD	Department of Defense
DOE	Department of Energy
FASA	Federal Acquisition Streamlining Act
FASAB	Federal Accounting Standards Advisory Board
FBF	Federal Buildings Fund
FDA	Food and Drug Administration
FFB	Federal Financing Bank
FSS	Federal Supply Service
FTE	full-time equivalent
GAO	General Accounting Office
GDP	gross domestic product
GPRA	Government Performance and Results Act
GSA	General Services Administration
GSF	General Supply Fund
HHS	Department of Health and Human Services
IFMS	Interagency Fleet Management System
ITMRA	Information Technology Management Reform Act
ITS	Information Technology Service
MINS	major item new start
NASA	National Aeronautics and Space Administration
NOAA	National Oceanic and Atmospheric Administration
NWQL	National Water Quality Laboratory
OMB	Office of Management and Budget
PBS	Public Buildings Service
PRIP	plant replacement and improvement program
SIR	surveys, investigations, and research
USGS	United States Geological Survey
WASC	Washington Administrative Service Center
WCF	working capital fund
VA	Department of Veterans Affairs

Introduction

Budgetary constraints and increasing demands to improve service have increased focus on the importance of federal agencies making wise and efficient use of resources to accomplish their missions. Some of these decisions require balancing short-term demands to fund day-to-day operations with needs to acquire assets that yield benefits over the long term. Spending for some assets may be necessary to produce program efficiencies and cost savings over the long-term. Some budget observers believe, however, that a bias is created against spending for long-term capital assets because of the requirement that the entire cost of these relatively expensive assets be budgeted for in an agency's or program's annual budget or "up-front" rather than spread over the life of the assets.[1] These concerns have led some to suggest that the federal government adopt a capital budget to spread the cost of long-lived assets across their useful lives. However, capital budgeting proposals have raised concerns among budget experts about fiscal control and accountability.

This report responds to a request by Representative William F. Clinger Jr., Chairman of the Committee on Government Reform and Oversight, to examine issues federal agencies face in planning and budgeting for the acquisition of capital assets. It also assesses ways that some federal organizations have developed to address those concerns and that could be used by other agencies within the existing budget structure. For the purposes of this study, the terms "capital assets" and "fixed assets" are used interchangeably and are defined as tangible assets that are owned by the federal government and that are primarily used in the delivery of federal services.[2] These types of assets are normally available in the commercial market and include buildings, equipment, and information technology.[3] Capital asset acquisition may take the form of rehabilitation of existing assets or development and construction of new ones. The

[1]Full funding or up-front funding is the provision of budgetary resources to cover the total estimated cost of a program or project at the time it is undertaken (regardless of when the orders will be placed or contracts awarded).

[2]In Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993), we defined "investment" as spending that is intended to increase the long-term productivity of the private sector. Investment spending is comprised of a subset of the government's total spending on physical assets, as well as some federal spending on intangible assets such as the conduct of research and development. Physical assets that would typically meet our definition of investment include highways, dams, and the air traffic control system. In Federal Budget: Choosing Public Investment Programs (GAO/AIMD-93-25, July 23, 1993), we described ways to distinguish between productivity-enhancing programs and spending programs with other goals such as stimulating or redistributing economic activity. This definition of investment differs from a common definition in which investment is any spending designed to generate long-term benefits.

[3]Not included are most national defense spending, grants to state and local governments, and spending for special purpose assets such as space stations, dams, environmental restoration, and national park lands.

primary focus of this report is on the capital planning and budgeting experiences of five case study organizations represented by four agencies: the Army Corps of Engineers, the Coast Guard, the General Services Administration's (GSA) Interagency Fleet Management System (IFMS) and the Public Buildings Service (PBS), and the U.S. Geological Survey (USGS).[4]

Capital Decisions Are Made in an Environment of Resource Constraints

Budgetary constraints have long had an influence on federal decision-making. Since 1970, the federal government's spending has consistently exceeded its income, resulting in pressure to restrain spending. Discretionary spending or the portion of the budget that lawmakers annually control through appropriations—which is the primary source for capital spending—has dropped from 12.2 percent of gross domestic product (GDP) in 1970 to 7.8 percent in 1995. In dealing with a shrinking resource base, it is inevitable that some agency missions may be curtailed, and some assets may not be, nor need to be, replaced. Thus, a decision not to fund a particular capital asset may reflect the outcome of competition with other capital projects and other types of expenditures as much as it does any characteristics of the budget process. Distinguishing between obstacles which are rooted in overall resource constraints and those which are an outflow of budget practices and rules is a difficult but critical task.

Agencies have often pointed to the poor condition of their existing capital assets as evidence of the need for increased capital spending. Articles in the popular press and past GAO reports have discussed the poor condition of various federal fixed assets, including the Pentagon, National Park Service facilities, Forest Service facilities, and many financial and information systems throughout government.[5] Moreover, spending on capital is often necessary to generate operational savings in the future. Some observers have been concerned that even as overall resources are limited, resources for capital assets are constrained even more because of the high initial cost of capital assets and what these observers believe to be the short-term focus of the budget process.

[4]A description of our criteria for selecting case studies appears in the "Objectives, Scope, and Methodology" section of chapter 1. We also provide limited, supplementary information on four additional organizations, the Food and Drug Administration (FDA), the Forest Service, the General Services Administration's Information Technology Service (ITS), and the National Oceanic and Atmospheric Administration (NOAA).

[5]See for example: DOD Rental Payments to GSA (GAO/T-GGD-92-31, April 8, 1992), National Park Service: Reexamination of Employee Housing Program Is Needed (GAO/RCED-94-284, August 30, 1994), Parks and Recreation: Resource Limitations Affect Condition of Forest Service Recreation Sites (GAO/RCED-91-48, January 15, 1991), Financial Management Issues (GAO/OCG-93-4TR, December 1992), and Information Management and Technology Issues (GAO/OCG-93-5TR, December 1992).

It is inevitable that resource constraints will prevent some worthwhile capital projects from being undertaken. However, decisions about whether any particular resource need—capital or operating—is funded reflect the priorities that are determined by the administration and the Congress. Ideally, those capital projects that are funded will be ones with the highest returns or that meet the highest priority mission needs. Therefore, the goal of the budget process should be to ensure neutrality vis-a-vis various types of spending so that decisions are guided by what is economically and programmatically justified rather than by what is recorded or "scored" most favorably in the budget.

Capital Spending Has Been Relatively Constant Over Time

It is reasonable to expect that historical budget data would give some indication as to how spending on capital has changed over time. However, the federal government does not aggregate data on capital asset spending in the same way that we have defined it in this report—spending on assets used in agency operations. One reason for this is that federal budget data is intended to serve multiple purposes. For capital spending, the data collected are used to highlight the level of investment activity (character class data) and to record the nature of the assets procured (object class data). Nevertheless, OMB's character class data, object class data, and program and financing data each provide some rough approximation for capital asset spending, and therefore, an approximate gauge of how such spending has fared over time.

OMB asks agencies to code their net outlays each year according to various investment categories or character classes. Investment outlays are defined by OMB as spending that is intended primarily to yield benefits in the future—whether to the nation as a whole or to the government. Investments may be in the form of direct federal spending or grants to state and local governments, and may be for tangible or intangible assets. The OMB categories that we have used to most closely match our definition are those for direct spending on physical assets.[6] However, the character class data will include some types of spending, such as for flood prevention and the acquisition of park land, which are excluded from our definition but cannot be easily segmented from the character class codes.

[6]These categories are Construction and Rehabilitation (1312 and 1314), Major Equipment (1322 and 1324), and Purchases and Sales of Land and Structures (1340). Major Equipment includes capital purchases of information technology but excludes the support services related to information technology purchases.

OMB also requires that agencies classify their obligations[7] by object of expenditure or object class. Object class schedules appear for each account in the President's budget.[8] The classifications for "Equipment" and "Land and Structures" are the closest approximation to our definition of capital assets, although they include some obligations which we exclude and omit others we would include. For example, some salaries and contractor costs that are devoted to capital projects are not included in these object class categories.

Finally, agencies may also identify their obligations as "capital investments" in the program and financing schedules that appear for each account in the President's budget. In these schedules, capital investments are acquisitions of physical or financial assets that yield benefits over several years. The program and financing classification capital investments is only shown when such investments are material for a program and represent nonreimbursable obligations. Agencies have discretion in defining programs, and consequently capital investments for this schedule. Therefore, some capital investments in the program and financing data may include items we would not consider capital and exclude others.

Despite the limitations of the available data, a review of historical trends can provide some perspective on the magnitude and overall pattern of spending for capital assets. (See figures 1.1 through 1.3.) OMB character class data show that direct[9] federal spending for "nondefense physical assets" in 1995 measured $19.5 billion and was about the same proportion of GDP and of total budgetary outlays as it was in 1970. Direct outlays for nondefense physical assets measured 0.26 percent of GDP in 1970, and in spite of ups and downs over the period, it represented about the same proportion in 1995. Likewise, as a percent of total budgetary outlays, direct spending for nondefense physical assets is basically unchanged from the 1970 level of 1.3 percent (although it did fluctuate over the period between 1.0 and 1.5 percent). Since these assets are primarily funded from the domestic discretionary category of spending, it may be insightful to compare trends against this portion of the budget. Here, too, we found that

[7]Obligations are binding agreements—orders placed, contracts awarded, services received, etc.—that will result in outlays immediately or in the future.

[8]Credit financing accounts, which are non-budgetary accounts appearing in the President's budget, do not have object class schedules.

[9]Direct federal spending is spending by the federal government itself, rather than grants to state and local governments. This definition differs from the use of the term "direct spending" in the BEA. In the BEA, direct spending means entitlement authority, the Food Stamp Program, and budget authority provided by law other than appropriations acts.

direct spending on nondefense physical assets is about identical to the proportion it was 25 years earlier (7.7 percent in fiscal year 1995 and 7.4 percent in fiscal year 1970).

Figure 1.1: Direct Nondefense Physical Capital Outlays as a Percent of GDP

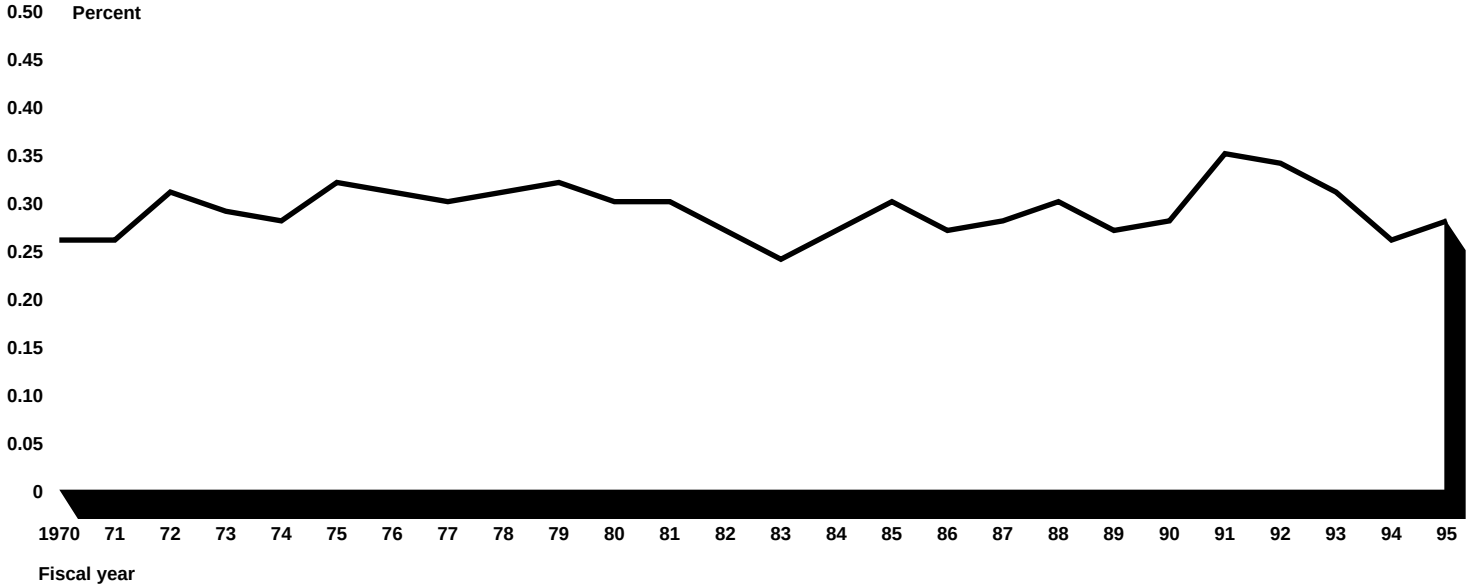


Figure 1.2: Direct Nondefense Physical Capital Outlays as a Percent of Total Federal Outlays

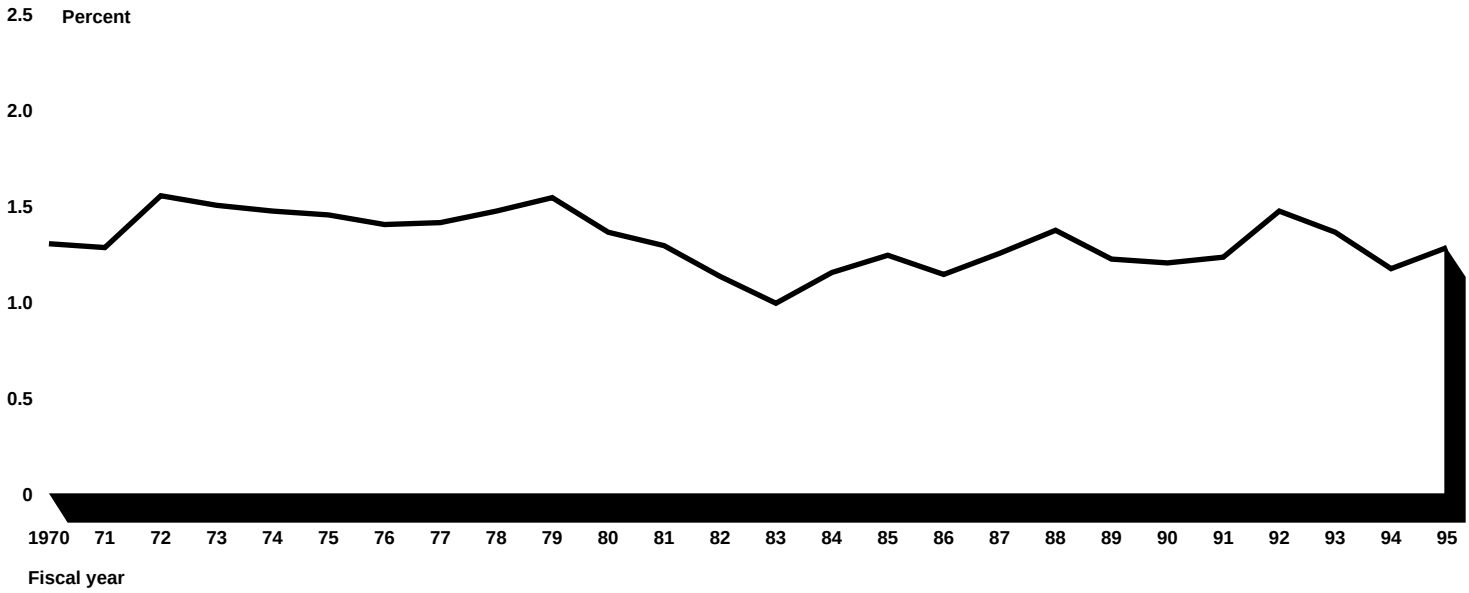
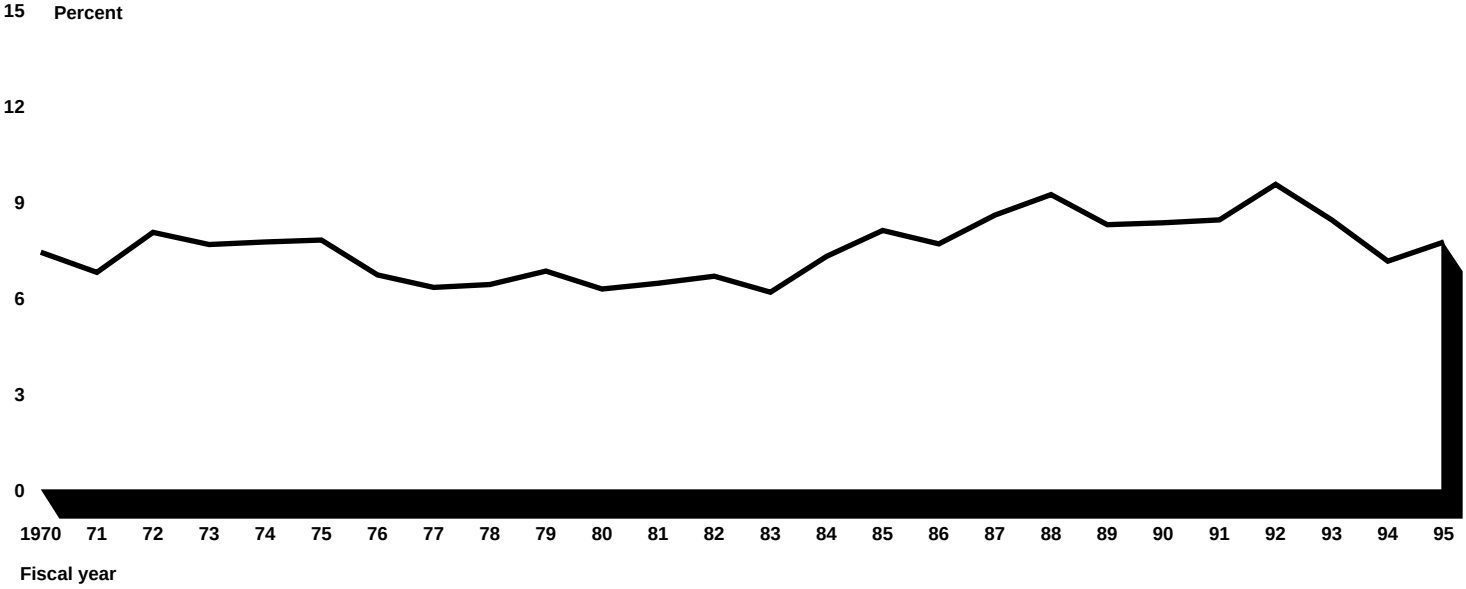


Figure 1.3: Direct Nondefense Physical Capital Outlays as a Percent of Domestic Discretionary Outlays



Historical budget data for our four case studies also show that spending on capital assets has not necessarily fared poorly relative to operations and programs.[10] (Appendixes II through VI provide graphical analysis of agency trends.) Each case study experienced at least a modest increase in its overall budget in real terms between 1982 and 1995.[11] For both GSA entities, capital obligations as a percent of total obligations have generally increased since 1982. For two other agencies, USGS and the Corps of Engineers, the proportion of obligations and outlays, respectively, made for capital assets over time has fluctuated up and down. In contrast, the Coast Guard has seen a steadily decreasing proportion of its outlays go toward capital assets.

Caution is required in interpreting the significance of these trends. This is not solely due to the limitations noted above. Neither the overall federal data nor the case study trend data provide any indication as to whether the

[10]Although the term spending typically refers only to outlays, due to data limitations we have used data measured in both outlays and obligations. For purposes of simplicity in this report we refer to both types of data as spending.

[11]Data limitations prevented us from analyzing capital spending by all case study agencies prior to 1982.

past levels of capital obligations or outlays were deficient, adequate, or excessive. Nor can the data indicate whether there is a bias in one direction or another. Trends could reflect changes in priorities between capital and other spending or changes in underlying needs for capital. Economies of scale in operations may suggest that in some cases operating expenses should decline relative to capital. In contrast, advances in technology may enable agencies to maintain consistent levels of operations while reducing their spending on capital assets.

Private Sector and Federal Practices for Budgeting for Capital Differ

As agencies try to adopt more business-like practices, it is inevitable that comparisons are made with private-sector practices in budgeting for capital. Some observers have noted that when it comes to acquiring capital assets, businesses—unlike government agencies—are able to spread the expense of capital assets by depreciating their value in income statements over the estimated useful life. Budget practitioners rightly observe that because of the cash basis of the federal budget, there is a difference between the timing of the costs and benefits of capital assets. While the benefits of capital assets flow over time, federal budget rules require that their full cost be recognized in the budget when acquired. This has been equated to a business charging the full cost of capital assets to a single year's income statement. Doing so would distort the true profitability of the firm in that year and make the cost of capital asset acquisitions appear artificially high. However, although the budget is occasionally called upon to serve the purpose of an income statement as well, it is not designed to measure profitability and is poorly suited for this role. In both the public and private sectors, budgets generally are a means through which organizations allocate resources.[12]

For many years there has been discussion of the federal government adopting separate capital and operating budgets. Under many such proposals, capital assets would be financed over time by borrowing—with depreciation charged each period to the operating budget (which under most proposals would be required to be balanced). Such proposals, however, fail to recognize key differences between budgeting and accounting. While depreciation is appropriate for helping companies measure profit or loss in financial statements, it is generally not used by companies in budgeting. They base capital spending decisions on present value comparisons of total cash inflows and outflows that are expected to

[12]Some private-sector businesses include depreciation in their operating budgets, but those operating budgets are totally accrual-based and, therefore, similar to income statements. They are, therefore, unlike the operating budgets described in most capital budgeting proposals for government. Businesses use cash and capital budgets to allocate resources.

result from alternative capital projects. Depreciation is not a cash flow and therefore affects a company's capital spending decisions only to the extent that, as a tax deduction, it affects the amount of cash outflow for income tax. A company's capital budget reflects the results of its spending decisions and records the cash requirements for its selected capital projects that are expected during each period. In this manner, a business' capital budget has some similarity to the federal unified budget, which also records the cash requirements for capital projects during each year. If depreciation were recorded in the federal budget in place of cash requirements for capital spending, this would undermine Congress' ability to control expenditures because only a small fraction of an asset's cost would be included in the year when the decision was made to acquire it.[13]

Federal Spending Is Guided by Budgetary Controls

The Antideficiency Act, as amended, implements Congress' constitutional oversight of the executive branch's expenditure of funds. The act reflects laws enacted by the Congress since 1870 to respond to abuses of budget authority and to gain more effective control over appropriations. The central provision of the act (31 U.S.C. 1341(a)(1)) prevents agencies from entering into obligations prior to an appropriation or from incurring obligations that exceed an appropriation, absent specific statutory authority. Thus, agencies may not enter into contracts that obligate the government to pay for goods or services unless there are sufficient funds available to cover their cost in full. Instead, agencies must budget for the full cost of contracts up-front. Also, the Adequacy of Appropriations Act (40 U.S.C.11), established in 1861, prohibits agencies from entering into a contract unless the contract is authorized by law or there is an appropriation to cover the cost of the contract.

While these acts require that agencies have sufficient appropriated funds to cover their obligations, the Budget Enforcement Act of 1990 (BEA) created new mechanisms by which to limit federal spending overall. BEA formalized the distinction between direct and discretionary spending and provided separate controls for each. Discretionary spending is defined as budget authority provided in annual appropriations acts, while direct or mandatory spending is that which is provided by law other than annual appropriations acts. To control discretionary spending—including spending for fixed assets—BEA established strict dollar limits or "caps" on

[13]See Budget Issues: Incorporating an Investment Component in the Federal Budget (GAO/AIMD-94-40, November 9, 1993) and Budget Issues: The Role of Depreciation in Budgeting for Certain Federal Investments (GAO/AIMD-95-34, February 1995).

budget authority and outlays for each fiscal year through 1998.[14] These caps are implemented through allocations to House and Senate appropriations committees, who subsequently allocate these totals among their subcommittees. The Congressional Budget Office (CBO) and OMB "score" or track budget authority, receipts, and outlays estimated to result from enacted legislation. Should a breach of the caps occur, BEA established a process called sequestration in which spending for most discretionary programs is reduced by a uniform percentage.

As a result of BEA, scorekeeping guidelines, called scoring rules, were developed that significantly changed how certain types of contracts were scored in the budget. Previously, when an agency entered into a lease-purchase contract,[15] budget authority and outlays were scored over the period of the lease in an amount equal to the annual payments. The new guidelines changed this by requiring that budget authority for lease-purchases be scored up-front and outlays be scored over the period during which the contractor constructs or purchases the asset.[16] After BEA, a lease-purchase, which is tantamount to borrowing from the private sector, was no longer treated in the budget preferentially to borrowing by the Treasury to finance direct ownership. This effectively eliminated lease-purchases from consideration as a capital acquisition method that could be used to spread the cost of purchases over a period of years.

The benefits to the government as a whole and the disadvantages to individual agencies resulting from the change in lease-purchase scoring are illustrative of the dichotomy that can exist between agencies' and Congress's perspective on the budget process. Changes in the scoring of lease-purchases, while problematic from the perspective of an individual agency because of up-front funding requirements and budget caps, are critical to enabling the Congress to control the total commitments made by agencies. Likewise, some ideas agencies propose to alleviate their perceived obstacles to capital spending may in turn create obstacles to maintaining fiscal control if implemented on a governmentwide basis. In this regard, there is a constant tension between agency and congressional perspectives on the nature of capital acquisition problems and their solutions.

[14]In 1996, the caps were proposed to be extended through fiscal year 2002.

[15]Lease-purchases are a type of lease in which ownership of the asset is transferred to the government at or shortly after the end of the lease period.

[16]This applies to lease-purchases in which the government assumes substantial risk of ownership. Scorekeeping guidelines provide criteria for determining the relative risk.

The Nature of This Report

This report illustrates how a select group of federal organizations plan and budget for capital assets and the experiences they have had with the budget process. Five case studies were selected to include a broad range of characteristics—large and small organizations, operations-intensive and capital-intensive organizations, and organizations having a range of asset needs and account structures. While it is inappropriate to generalize about governmentwide practices in budgeting for capital from these case studies, it is possible to gain insight into some issues and discover potential strategies for addressing these issues. The information obtained from the case studies, supplemented by a limited number of interviews at other agencies that purchase capital assets, provides some indication of the range of issues that may be encountered governmentwide.

Because agencies can differ substantially in their asset requirements, account structure, financial management history, and other characteristics, care must be taken in applying lessons from one agency to another. The chapters that follow include issues that generally affect all federal organizations, such as the requirement to fully fund capital acquisitions up-front, as well as issues that may be limited to selected organizations as a result of their particular characteristics. Likewise, any strategy that an agency has adopted to deal with its perceived obstacles to capital spending has been tailored for its specific circumstances. Some may be adaptable to other agencies; others may not be. The report is also not exhaustive with respect to the problems and strategies of case studies. Some financing strategies, such as budgeting for stand-alone stages of a larger capital project, may be used by case studies other than those explicitly mentioned in this report. Similarly, case studies may be using other financing approaches in addition to those cited.

This report is not intended to represent a final or universal solution to the problems in budgeting for capital assets. Indeed, other issues would also need to be addressed if the capital acquisition process is to be improved. For example, the selection and evaluation of capital projects must be improved. GAO's past work has identified a variety of federal capital projects including information technology as well as large-scale construction projects where acquisitions have yielded poor results—costing more than anticipated, falling behind schedule, and failing to meet mission needs.[17] In addition, to effectively evaluate program performance as called for in the Government Performance and Results Act

[17]See for example Managing for Results: Steps for Strengthening Federal Management (GAO/T-GGD/AIMD-95-158, May 9, 1995), Space Station: Program Instability and Cost Growth Continue Pending Redesign (GAO/NSIAD-93-187, May 18, 1993), and Fossil Fuels: Improvements Needed in DOE's Clean Coal Technology Program (GAO/RCED-92-17, October 30, 1991).

of 1993 (GPRA), agencies will need data on the full annual cost of programs including the cost of capital usage.[18]

Objectives, Scope, and Methodology

The objectives of this study were to examine (1) how case study organizations perceive the budget process and structure affects their ability to acquire capital assets, (2) whether there are financing mechanisms currently used or proposed by our case studies that could be helpful in improving budgeting for capital assets within the current unified budget structure, and (3) the results of OMB's Bulletin 94-08 on "Planning and Budgeting for the Acquisition of Fixed Assets."

To identify aspects of the budget process that affected case studies' capital spending decisions and the financing mechanisms they used and proposed, we interviewed officials from our case studies as well as OMB and congressional staff responsible for reviewing the budgets of these organizations. To select our case studies, we used data from OMB's MAX[19] system to identify federal organizations making capital expenditures between fiscal years 1982 and 1994 and the general type of assets they acquired. We developed an initial short list of organizations that provided coverage across various departmental levels of government and asset types. The short list consisted of the Army Corps of Engineers, the Coast Guard, the Forest Service, the Food and Drug Administration (FDA), the General Services Administration (GSA),[20] the National Oceanic and Atmospheric Administration (NOAA), and the U.S. Geological Survey (USGS).

We reviewed our past work and other literature to identify organizations among the short list that had expressed difficulty in acquiring capital assets and/or were using a financing mechanism that helped alleviate this difficulty. After conducting initial interviews with officials at each of the short list organizations to confirm the issues they face and the assets acquired, we agreed with the requestor to select five case studies representing four agencies: the Army Corps of Engineers, Coast Guard, GSA

[18]Under GPRA, agencies must develop, no later than by the end of fiscal year 1997, strategic plans that cover a period of at least 5 years and include the agency's mission statement; identify the agency's long-term strategic goals; and describe how the agency intends to achieve those goals through its activities and through its human, capital, information, and other resources. GPRA also requires each agency to submit to OMB, beginning for fiscal year 1999, an annual performance plan. In essence, the annual performance plan is to contain the annual performance goals the agency will use to gauge its progress toward accomplishing its strategic goals and identify the performance measures the agency will use to assess its progress.

[19]MAX is the computer system used to collect and process information needed to prepare the budget.

[20]We considered three separate operating entities within GSA—the Public Building Service, the Interagency Fleet Management System, and the Information Technology Service.

(the Public Building Service (PBS) and the Interagency Fleet Management System (IFMS)),[21] and USGS. Our selection of case studies was based on a goal of choosing organizations that reflected diversity in the types of assets acquired, the volume of capital spending, the type of account used, and the appropriations subcommittees. Table 1.1 (see p. 33) shows the types of assets case studies acquire and the account(s) used to finance capital. After conducting more extensive interviews with officials of our case studies, we discussed the organizations' problems and financing mechanisms with staff of the case studies' House and/or Senate appropriations subcommittees, as well as OMB program examiners and policy specialists.

GAO requested comments on a draft of this report from the Secretary of Defense, the Secretary of the Army, the Secretary of Transportation, the Secretary of the Interior, the Acting Administrator of GSA, and the Director of OMB. At meetings conducted in August and September of 1996, these officials' designees provided their comments. Their comments are discussed and evaluated in chapter 6 and certain other sections of the report as appropriate.

To examine the responses to OMB Bulletin 94-08 on "Planning and Budgeting for the Acquisition of Fixed Assets," we reviewed submissions OMB received from agencies. We discussed the bulletin with officials of each of our case studies and with OMB officials responsible for the bulletin's development and implementation. We also had discussions with OMB to determine differences in the responses to and results of OMB's second bulletin on fixed assets (Bulletin 95-03). To improve the currency of our discussion of OMB's fixed asset efforts, we also reviewed OMB's A-11 guidance to agencies on submitting their fiscal year 1998 budget requests.

Capital spending data in appendixes I through VI and chapter 1 were derived from OMB's MAX system. Although we did not verify this data at the individual budget account or organizational level, total obligations in the object class and program and financing schedules and total outlays in the character class schedules were reconciled by fiscal year to published sources.

We performed our work from June 1995 through February 1996 in accordance with generally accepted government auditing standards.

[21]For simplicity we refer to GSA as well as its operating entities as "agencies" throughout the report.

Table 1.1: Examples of Assets Acquired and Accounts Used to Finance Capital by Case Studies

Case study	Examples of assets acquired	Account(s) used to finance capital
Army Corps of Engineers	Equipment, facilities, information systems	Revolving fund[a]
Coast Guard	Vessels, aircraft, shore facilities, information technology	Acquisitions, construction, and improvements
GSA: Interagency Fleet Management System	Motor vehicles	General supply fund
GSA: Public Buildings Service	Office buildings, courthouses, special purpose buildings	Federal buildings fund
U.S. Geological Survey	Information systems, telecommunications, and scientific equipment	Surveys, investigations, and research; working capital fund

[a]Although Corps fixed assets used on multiple civil works projects are acquired through a revolving fund, other fixed assets are acquired through the Corps appropriations accounts, including the Construction, General, and the Flood Control, Mississippi River and Tributaries accounts.

Agency and Governmentwide Perspectives on Up-Front Funding Differ

The Adequacy of Appropriations Act and the Antideficiency Act require that resources be available to fulfill government commitments to pay for goods and services when the commitments are made, or up-front. However, officials at the organizations we contacted typically viewed the requirement as an impediment to their meeting capital asset needs. Managers expressed concern that their agency or program budgets are not able to accommodate the large, single-year increases in budget authority needed to fully fund capital projects up front. As a result, managers believe that capital needs are either not met or met through methods that are more costly in the long term.

Despite the potential problems for individual agencies, up-front funding is critical to safeguarding Congress' ability to control overall federal expenditures and to assess the impact of the federal budget on the economy. Without up-front funding, projects may be undertaken without adequate attention being given to their overall costs and benefits. Moreover, failure to fully fund projects before they are undertaken can distort the allocation of budget resources and obscure the impact of federal budgetary action on the private sector. Only a few agencies, including the Army Corps of Engineers (one of our case studies), have been exempted from the up-front funding requirement. Despite these agencies' use of incremental funding,[1] OMB has taken steps to encourage consistent application of up-front funding across government in the future.

Agencies View Up-Front Funding as an Impediment to Capital Acquisition

Managers in most of the organizations we contacted cited requirements for full up-front funding as an obstacle to acquiring capital assets. These officials felt that when it is necessary to purchase expensive capital assets, up-front funding requirements result in a spike in their agency's or program's budget authority that often would not be provided in the current budget environment. Although an asset may be an important component to carrying out the mission of the organization and may bring benefits over many years, managers believed that having to budget for the full cost in 1 year is often a significant impediment to its acquisition. Although general resource constraints are not new, full up-front funding has become more difficult because most capital spending is discretionary and, thus, annually capped by BEA. OMB has responded to BEA by frequently imposing limits on agency spending and by prohibiting agency borrowing. Consequently, managers may find themselves faced with a situation in which funding an expensive capital project may require deep cuts in operations or in all

[1]Incremental funding occurs when the Congress provides funds for a capital acquisition based on the obligations estimated to be incurred within a fiscal year when such funds will not produce a usable asset.

other capital projects during that year. Faced with these trade-offs, agency managers may either delay capital projects until an additional appropriation can be obtained or, when possible, look for other ways of meeting their capital needs though the long-run cost may be higher.

Officials from virtually every organization that we contacted could cite examples of how the up-front funding requirement affected their ability to acquire capital. Up-front funding appeared to be a particularly significant issue at organizations we contacted that acquire buildings because these assets often have a high initial cost, provide benefits over many years, and could be financed over an extended period of time. Up-front funding was also a concern for USGS in acquiring equipment because the cost of the equipment sometimes represented a significant portion of the organization's resources.

PBS has often cited the up-front funding requirement as an impediment to meeting federal agency space needs in the most cost-effective manner. PBS is responsible for acquiring general and special purpose work space for federal agencies and has multiple methods available for meeting these space needs, including operating leases, capital leases, lease-purchases,[2] and direct purchases. Each of these methods for obtaining space presents a combination of advantages and disadvantages in terms of flexibility and short- and long-term cost to PBS. Budget scoring rules are intended to facilitate comparisons of the long-term cost of each method and to ensure compliance with the full funding concept. For each space acquisition method except for operating leases, PBS (like other federal organizations) is required to have budget authority for the total cost up front even though the outlays may occur over several years.[3] PBS has generally found that ownership is the least costly manner with which to meet long-term federal space needs. However, PBS officials indicated that the up-front funding requirement coupled with caps on total discretionary budget authority and outlays has resulted in PBS not receiving sufficient budget authority to allow it to own the amount of office space that its studies indicate to be optimal. PBS has maintained that by relying on operating leases instead, the government incurs a higher long-term cost and consumes resources that could be used for repairs and alterations of the existing inventory.

[2]Operating leases and capital leases differ from lease-purchases in that the ownership of the asset is not transferred to the lessee at the conclusion of the operating or capital lease period. Operating leases are distinct in that they are generally for shorter term needs and all risks of ownership of the asset remain with the lessor.

[3]For purchases and for lease-purchases in which the government assumes substantial risk, the outlays must be budgeted for over the period of construction or purchase.

Other organizations felt similar constraints on their ability to obtain or replace facilities. Coast Guard officials, for example, cited a need for new employee housing. The Coast Guard prefers to satisfy housing needs by providing allowances to employees to rent from the private sector. However, in remote or resort areas of the country where affordable rental housing is not available, the Coast Guard constructs housing. Coast Guard officials stated that even though the housing fulfills a long-term need, they must budget for the full cost in a single year, which generally limits the number of capital projects that can be undertaken. Officials at the Forest Service also felt that up-front funding requirements in conjunction with resource constraints prevented them from making investments in buildings and facilities. Many of the agency's facilities are in very poor condition and in need of repair or replacement.[4] However, Forest Service managers say they are not able to obtain the large increases in appropriations needed to meet these one-time costs.

FDA officials also felt that up-front funding was an obstacle to acquiring needed facilities. They felt that some of their facilities were in need of repair or replacement, but that many of these cannot be undertaken because their cost must be budgeted for up-front. In addition, FDA has been waiting for a number of years to obtain funding to consolidate headquarters staff that are currently spread out across many different locations in the Washington, DC metropolitan area into fewer sites. FDA officials believe that the segmentation of their facilities increases their operating cost and makes it harder to fully use some pieces of equipment that could be shared if staff were consolidated into fewer facilities.

Up-Front Funding Is Paramount to Governmentwide Fiscal Control

Although possibly problematic for individual agencies, up-front funding has long been recognized as an important tool for maintaining governmentwide fiscal control. The requirement that budget authority be provided up-front, before the government enters into any commitment, was established over 100 years ago in the Adequacy of Appropriations Act and the Antideficiency Act. These acts responded to past problems in which agencies committed the government to payments that exceeded the resources made available to them by Congress.

The importance of the principle was reinforced by the 1967 Report of the President's Commission on Budget Concepts, which emphasized the primary purposes of the budget as being the efficient allocation of

[4]See Parks and Recreation: Resource Limitations Affect Condition of Forest Service Recreation Sites (GAO/RCED-91-48, January 15,1991).

resources and the formulation of fiscal policy to benefit the national economy. The up-front funding requirement advances both. It is essential for efficient resource allocation decisions because it helps ensure that the Congress considers the full cost of all proposed commitments and makes trade-offs based on full costs. To be useful in the formulation of fiscal policy, the budget must be able to highlight the impact of the federal budget on the economy. For this purpose, the requirement for up-front funding also serves the Congress well. The point at which capital spending has the largest and most direct economic impact on the private sector occurs at the point the commitment is made—that is, up-front—not over the expected lifetime of a long-lived asset.

Failure to recognize the full cost of a particular type of expenditure when budget decisions are being made could lead to distortions in the allocation of resources. In other words, if particular types of spending, such as for physical assets, were given preferential treatment in the budget by virtue of recognizing only a fraction of their total cost, then it is likely that relatively more spending for those types of assets would occur. While advocates for purchasing some federal assets may see this as a desirable end, such an outcome may not accurately reflect the nation's needs. In particular, other types of federal spending that also provide long-term benefits but that are not physical assets (including research and development and spending for human capital) would be arbitrarily disadvantaged in the budget process, even if national priorities remain unchanged.

Furthermore, failure to fully fund capital projects at the time the commitment is entered into can force future Congresses and administrations to choose between having an unusable asset and continuing projects' funding for years even after priorities may have changed. For example, if the Congress provides funding for only part of a project and that part is not usable absent completion of the entire project, then the Congress and the administration may feel compelled to continue funding in the future to avoid wasting the initial, partial funding that was already spent. Thus, if capital projects are begun without full funding, future Congresses and administrations may, in effect, be forced to commit a greater share of their annual resources to fulfilling past commitments and thus have less flexibility to respond to new or changing needs as they arise.

Although the organizations we contacted may perceive it to be difficult to obtain full funding in a single year for capital assets, OMB and the Congress

have at various times accommodated agencies' needs for large increases in budget authority to fully fund their capital projects. However, given overall resource constraints, all of the capital needs (and operating needs) that agencies may have or perceive cannot be met. Thus, an agency's failure to receive funding for its capital request may reflect the fact that, on a governmentwide basis, other agencies' capital projects are of higher priority to OMB or the Congress. It also reflects governmentwide trade-offs that are made to continue funding operations of one agency over increases in capital spending at other agencies.

A Few Agencies Have Been Exempt From Up-Front Funding

Although up-front funding is generally required across government, it is not applied to all agencies. Water resource projects were explicitly exempted from up-front funding by the Rivers and Harbors Appropriation Act of 1922. As a result, the Corps of Engineers implements many of its construction projects through the use of continuing contracts. These contracts cover the entire project but indicate the amount of work that is expected to be completed during each year and the cost of that increment. Although the Congress is aware of the total expected cost of the project, the Corps annually requests funding for the projects in increments—only the amount of money necessary to complete the next year's portion of work.

The Corps' contracts are structured so that it is not committed to paying for any additional work on a project beyond that specified for the budget year. If the Congress were to discontinue funding for the project at some point during the overall contract, the Corps would be responsible for paying the contractor various cancellation or decommissioning costs. However, while the Corps is not legally obligated to complete an incrementally funded project, terminating it before completion can leave the Corps without anything of economic value. Corps officials suggest however, that because of the costs that have already been incurred and the economic justification that is done before beginning any project, it is unlikely that the Congress would choose to cancel a project for fiscal reasons once it is begun. In fact, the officials indicated they are not aware of any Corps projects that have been cancelled by Congress.

The Energy and Water Development appropriations subcommittees have been comfortable with incrementally funding the Corps and other agencies within their jurisdiction (such as the Bureau of Reclamation and DOE) and have not changed the practice. Officials from OMB and the Corps indicated that the Carter administration had proposed to the Congress fully funding

Corps construction projects, but full funding was rejected because it would have required either a large increase in appropriations or a significant drop in the number of projects that could be undertaken in a given year.

One of the traditional concerns with incremental funding is that it risks allowing projects to be started before adequate scrutiny is given to their total cost and benefit. Some within OMB have suggested that this may not be as much of a concern with the Corps, in part because both OMB and the Congress have had confidence in the Corps' total cost estimates because of the historical reliability of its cost-benefit justifications. Thus, the Congress is aware of the costs and the benefits of a project before it is authorized. OMB officials also indicated that other factors contribute to ensuring that projects are managed cost effectively. For example, state or local authorities that act as financial partners in Corps projects have a strong incentive to ensure that projects are well-managed. In addition, project authorization levels limit the amount of additional appropriations the Corps can obtain for cost overruns.

OMB has acknowledged that agencies have not always requested or received full up-front funding for capital acquisitions. Besides the Corps of Engineers, some capital projects at the Bureau of Reclamation, DOE, and NASA have also been funded incrementally. One of the objectives of OMB's bulletins on fixed assets (Bulletins 94-08 and 95-03) was to identify the extent to which incremental funding was being used and to encourage agencies to request full funding for their capital projects.

Estimates are still being refined by OMB as to what the total cost would be to fully fund all projects currently funded incrementally. In the fiscal year 1997 President's budget, OMB requested $1.4 billion in budget authority to fully fund selected ongoing projects in DOE and NASA that otherwise would have been incrementally funded.[5] Although full funding was not requested for capital projects at the Corps of Engineers and the Bureau of Reclamation, the President's budget indicated that the cost of fully funding ongoing and new projects for these two agencies would be about $23 billion in fiscal year 1997 (which represents 11 percent of total domestic discretionary budget authority in fiscal year 1995). The implications of fully funding capital projects—including those that have been incrementally funded—will be clarified for the government as a

[5]Only a small portion of this request was ultimately approved in fiscal year 1997 appropriations actions.

whole when agencies submit their fiscal year 1998 budget requests to OMB.[6] The principal effect will be to increase budget authority in the initial year for projects that would otherwise be incrementally funded over a period of years. Because projects' cash flows would be unaffected by the application of up-front funding, the government's total annual outlays would also not change for a given level of capital projects. For the longer term, the impact of such a shift on future years' budget authority will be a function of whether policymakers change the number or types of capital acquisitions in response to the up-front funding requirement.

[6]As discussed in chapter 5, OMB is requiring agencies to request full up-front funding for stand-alone stages of all ongoing and new fixed asset acquisitions in their fiscal year 1998 budget submissions.

Up-Front Funding Can Be Accommodated by Balancing Managerial Flexibility and Congressional Control

Case studies use a variety of methods for adapting to the requirement to fully fund capital acquisitions up-front. Some of these methods demonstrate a balance between managerial flexibility and congressional control. They include:

- budgeting for stand-alone stages of an acquisition,
- revolving funds,
- an investment component within a working capital fund,
- reducing capital needs, and
- operating leases.

Several of these approaches to financing capital may be worthwhile for other agencies to consider to help accommodate the up-front funding requirement. For example, one case study uses contracting strategies that are designed to limit the government's commitment and spread the amount of budget authority needed over a period of years. Under certain conditions and for certain types of capital acquisitions, revolving funds and investment-type accounts can serve to manage the spikes in resource needs that are created for an agency by up-front funding. Case studies have also pursued strategies intended to reduce their need to own capital assets and to lower their overall cost of operations so that capital spending may be more easily accommodated. Yet some case studies, unable to meet long-term capital needs with current resources, use financing methods, such as operating leases, that are better suited for meeting short-term needs and that can lead to higher long-term cost. Finally, officials of some case studies believe that additional tools would be useful, such as borrowing authority and partnerships with the private sector. While these proposed tools would enhance managerial flexibility, they must be considered in light of their impact on congressional control.

Budgeting for Stand-Alone Stages of an Acquisition Limits the Budget Authority Needed

The Coast Guard requests funding for separate stand-alone stages of large capital projects. In contrast to incremental funding, budgeting for stand-alone stages helps ensure that a single appropriation will yield a functional asset while limiting the amount of budget authority needed. For example, the Coast Guard may structure its vessel and other equipment contracts to acquire portions of such projects that are economically or programmatically useful even if the entire project is not completed as planned. In acquiring a class of ships, the Coast Guard may write a contract for a lead ship and spare parts with options to buy additional ships in future years. By structuring its acquisitions in this way, the Coast Guard can request full funding for each useful piece of the project as the

project progresses, rather than requesting funds for the entire project up-front. This strategy reduces the budget authority needed by the Coast Guard to initiate the project and is consistent with full funding because the Coast Guard receives a useful asset from each funded option, though the full value of the asset may not be realized until the entire project is completed.

The Coast Guard's experience indicates that structuring a capital acquisition into fully-funded, stand-alone stages has several advantages to agencies and the Congress. First, it allows agencies to spread the amount of budget authority needed to complete a large capital acquisition over multiple years. For the agency and for the Congress, this can enable more projects to be underway concurrently. A second advantage is that the Congress can exercise more frequent oversight over the progress of the total capital project. As each usable portion of the total project is completed, the Congress has an opportunity to review progress, re-evaluate needs, and decide whether to provide funding for the next segment. Third, budgeting for stand-alone stages of a project gives the Congress greater funding flexibility to respond to changing needs or national priorities. If changing circumstances dictate that other needs are of a higher priority, the Congress can discontinue the project at an appropriate juncture, shift funds to the new need, and still benefit from the funds already spent on the stand-alone stages.

Agency managers, of course, would prefer to receive funding for the entire project at the outset since that would reduce uncertainty, make project management easier, and possibly lower the cost contractors charge. However, it is appropriate from an overall federal budgeting perspective for projects spanning multiple years and requiring significant resources to be re-evaluated as they progress, with the Congress maintaining the option to end the project. Decisions to terminate or slow down projects reflect current budget priorities given available resources. If projects have been funded in stand-alone stages, such decisions can be made without the concern that past spending has been wasted. On the other hand, even though the assets are usable, their net effectiveness may be compromised if the succeeding parts of the project are not completed as well.

Revolving Funds Can Be Effective in Spreading the Cost of Capital Acquisition Over Time and Incorporating Capital Costs Into Operating Budgets

Four case studies used revolving funds[1] to finance capital assets and manage the spikes in resource needs that can occur with up-front funding. Their experiences indicate that revolving funds can be effective for agencies with relatively small, ongoing capital needs because the funds, through user charges, spread the cost of capital over time in order to build reserves for acquiring new or replacement assets. In addition, revolving funds help to ensure that capital costs are allocated to programs that use capital. However, revolving funds do not always work as intended. For example, while revolving funds are intended to be self-financing, PBS' revolving fund has faced several structural constraints that have limited its ability to satisfy customer needs with the fund's rental income. Case studies' experiences led us to conclude that revolving funds will be most effective when they possess certain characteristics—sound financial management, identifiable customers to charge, the ability to recoup replacement cost, appropriations to fund major expansions to the asset base, and the ability to retain proceeds from the sale of assets when expected to maintain the same size asset base. In addition, to ensure opportunities for oversight and control, revolving funds also need to have capital plans, including expected benefits from the acquisition against which actual benefits may be judged. Equally important, for revolving funds that acquire large-scale and heterogeneous assets, the Congress and OMB must be able to annually review whether proposed acquisitions are those most needed and whether the overall level of capital spending by the agency is appropriate given other competing capital and operating needs across the government.

Revolving Funds Were Widely Used by Case Studies

Case study organizations showed that revolving funds are neither a new nor rare tool in budgeting for capital assets. Case studies also demonstrated that revolving funds can be used in a variety of circumstances. At some case studies, the revolving funds primarily provide assets to external customers, while at others, the assets are used primarily to support internal operations. However, regardless of the particular types of assets or the customers to whom the services are provided, revolving funds relied on charges to users to fund ongoing maintenance and replacement of capital assets.

[1]Revolving funds are accounts authorized to be credited with collections that are earmarked to finance a continuing cycle of business-type operations without fiscal year limitation. For intragovernmental revolving funds, collections primarily come from other government agencies and accounts. However, OMB officials commented that, although the four case studies have accounts classified in the budget as revolving funds, only the IFMS revolving fund, which can spend its collections without annual appropriations, meets this definition.

The Corps of Engineers has used a revolving fund since fiscal year 1954 to finance equipment and facilities shared by multiple Corps civil works projects and programs. The original cost of the equipment is charged as a depreciation cost to the projects or programs that use it. In addition, user charges are set to recover expected increases in the asset's price. By including depreciation and inflation in its charges to users, the revolving fund ensures that resources are available to buy new equipment when necessary.

The Congress established USGS' working capital fund (WCF)[2] in fiscal year 1991 to finance replacement of the agency's mainframe computer, telecommunications equipment, and related automated data processing (ADP) equipment. The WCF grew out of USGS' experience in having to finance a telecommunications upgrade and mainframe computer from annual appropriations. USGS recognized that it needed a way to plan for the augmentation or replacement of these acquisitions in the future if it was to reduce the one-time impact on operating units. Through the WCF, charges to users will help fund the replacement of these assets.[3]

The IFMS uses a revolving fund to finance operations of its fleet of vehicles. Since 1982, IFMS charges to client agencies have enabled it to recover depreciation, operational costs, and an inflation increment.[4] The revolving fund accumulates reserves during the year so that portions of the fleet can be replaced as needed; proceeds from the sale of old vehicles are also applied toward new purchases. The revolving fund is intended to be self-sustaining and IFMS tries to ensure that its user charges are competitive with those of private-sector car rental providers.

GSA's Information Technology Fund (ITF) was initially established in 1987 and currently funds, on a reimbursable basis, federal local and long-distance telecommunications services and ADP technical services. Fees charged to client agencies recover the full cost of services plus contributions to a capital reserve fund. The capital reserve fund finances replacement of ITF fixed assets—primarily PBX and telephone switches used for local phone service. The ITF also uses its capital reserve fund to finance extraordinary operating expenses related to long-distance service and to finance pilot projects.

[2]A working capital fund is a type of intragovernmental revolving fund.

[3]In 1995, the Congress gave USGS permission to expand its investment component to the WCF to fund replacement of scientific equipment and facilities improvements. A fuller discussion of the USGS investment component is found later in this chapter.

[4]Prior to 1982, IFMS had been unable to charge for inflation.

The Federal Buildings Fund (FBF) began operations in 1975 and is the largest of the revolving funds at GSA. PBS, which manages the FBF, charges client agencies rent for buildings it provides for their use. Like other revolving funds, the FBF is intended to be self-financing. The charges to users are intended to cover all costs of operations and replacement and a limited amount of new construction. In practice, the FBF has been faced with customer demands for new space that exceed collections. As a result, PBS has sought appropriations to supplement the Fund's income. PBS officials cited a number of structural constraints placed on the FBF, such as congressional restraints on the generation and use of FBF income that have prevented it from operating like a true revolving fund. Nevertheless, they believe that the FBF has been a more effective method of financing the maintenance and replacement of assets than was the former process of funding through appropriations alone.

Revolving Funds Can Promote More Cost-Effective Capital Decisions

In addition to the benefits they provide in smoothing spikes that can result from up-front funding, revolving funds can also help agencies and the Congress better monitor program costs by promoting full cost accounting.[5] Although full funding up-front leads to recognition of the full cost of commitments in the year made, when agencies finance capital through appropriations, the annual capital cost incurred in carrying out a specific program is not apparent in that program's budget. Revolving funds can ensure through their user charges that the full cost of programs—including capital usage—is borne on an annual basis by those responsible for the program rather than passed on to future users. At an agency level, revolving funds incorporate traditional capital budgeting concepts and can result in charging users for capital consumption without violating up-front funding principles for the federal government as a whole. As GPRA is implemented, full costing will take on even greater importance as managers will need to assess whether their programs are achieving goals in a cost-effective manner.[6] When the budget does not

[5]Managerial Cost Accounting Concepts and Standards for the Federal Government (Statement of Federal Financial Accounting Standards, Number 4) recommends that federal entities report the full costs of outputs in general purpose financial reports. This statement notes that such cost information can be used "by the Congress and federal executives in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance."

[6]Under GPRA, agencies must develop, no later than by the end of fiscal year 1997, strategic plans that cover a period of at least 5 years and include the agency's mission statement; identify the agency's long-term strategic goals; and describe how the agency intends to achieve those goals through its activities and through its human, capital, information, and other resources. GPRA also requires each agency to submit to OMB, beginning for fiscal year 1999, an annual performance plan. In essence, the annual performance plan is to contain the annual performance goals the agency will use to gauge its progress toward accomplishing its strategic goals and identify the performance measures the agency will use to assess its progress.

clearly identify all costs associated with a program, including capital usage, agencies and the Congress cannot make fully informed trade-offs among programs because some programs appear cheaper than they are.

Costs tied directly to capital usage also provide an incentive for agency managers to use capital more efficiently. In some cases this may lead them to reconsider whether they need the same quantity or type of fixed assets as previously thought. For example, as rent charges for work space become a greater burden for agencies (because of stagnant or declining annual budgets), it is reasonable to expect that more agencies will become concerned about their use of space and the resources it diverts from other purposes. Establishing economic incentives for agency managers to make their own trade-offs between capital and operations based on full costs is likely to lead to more efficient decisions about appropriate levels of capital assets.

Constraints on Revolving Funds Can Impede Effectiveness

Officials at IFMS and PBS expressed concern over financing constraints and/or underfunded responsibilities that could impede their revolving funds' ability to operate efficiently. The FBF in particular, has traditionally faced constraints on its ability to generate income. The FBF has also been faced recently with responsibilities that were not anticipated at the Fund's inception.

The IFMS' full-cost recovery pricing system has covered the costs of maintaining and replacing its fleet, but IFMS officials believe additional new requirements on IFMS may make cost recovery and remaining competitive more difficult in the future. The Energy Policy Act of 1992 requires that by fiscal year 1999, alternatively fueled vehicles must comprise at least 75 percent of the total number of new vehicles acquired by a federal fleet. Although law requires DOE to fund the incremental acquisition costs of alternatively fueled vehicles over their conventionally fueled counterparts, DOE officials indicated to IFMS that DOE had only a portion of the incremental funding needed for fiscal year 1996. Depending on the number of vehicles converted, IFMS officials thought that the remaining cost in fiscal year 1996 could be absorbed through operational efficiencies. However, the fund may not be able to accommodate future costs if advances from DOE continue to decline or cease altogether.

Although a revolving fund should fully recover its costs through user charges if it is to be self-sustaining, this has not been the case with the FBF. The imbalance between the FBF's costs and its income lies in part in the

inherent structure of the Fund. FBF rent charges to agencies are not necessarily sufficient to cover full costs because they are not based on the actual costs to PBS. In some cases, PBS' repair and maintenance costs are higher than the average for office buildings because it must maintain some of its office buildings as heritage assets. Since FBF charges agencies for their use of owned and leased space based on market appraisals made every 5 years, actual costs to maintain the space and FBF payments to the private-sector lessor may vary from the rental income FBF collects.[7] Adding to these constraints on PBS' cost recovery have been caps on rent. During the 1980s, the Congress believed some PBS rental charges were too high and imposed caps on the rents of some agencies. Although only three agencies currently have rent caps, PBS estimated that the caps have caused substantial income losses over the years.

Financing office space to satisfy customer needs may also be more difficult because the FBF is not authorized to retain the proceeds from the disposal of property. When PBS property is sold, all disposal proceeds are required by law to be deposited into a land and water conservation fund.[8] The other revolving funds operated by our case studies can retain disposal proceeds and have fewer restrictions on the disposal of assets. For the Corps of Engineers, the disposal proceeds are only a minor source of funding, but for IFMS they represent a substantial portion of operating income.

Constraints on income have been exacerbated by demands to expand PBS' asset base. During the 1980s, demands for courthouse construction began to rise significantly. Although PBS responded to early courthouse construction demands by deferring maintenance on other assets, PBS sought and received appropriations for courthouse construction in fiscal year 1991 to supplement the Fund's rental collections. The FBF has since continued to receive appropriations for construction of courthouses, border stations, and office space. However, PBS estimates that the present level of appropriations funds about half of construction costs. The remainder of the costs are primarily being covered by FBF rental collections, which are also used for funding repairs and modernization of the existing assets.

[7]PBS officials indicated that PBS plans to change its pricing of leases so that rents charged in the future would be based on the rent that PBS pays to the private-sector lessor.

[8]The same law also prevents PBS from retaining income from leases to nonfederal entities.

Several Factors Are Important for Effective Revolving Funds

Despite their benefits in smoothing out spikes in resource needs, revolving funds are not necessarily appropriate for all agencies or in all circumstances. Our review of case studies' revolving funds, as well as previous analysis of specific revolving funds,[9] has led us to draw some conclusions about the characteristics needed for successful revolving funds. First, agencies using a revolving fund need to have demonstrated a sound record of financial management. Financing capital through a revolving fund can entail a lesser degree of congressional control than direct appropriations. Not all agencies may have demonstrated a sufficient stewardship of government resources to warrant a reduction in congressional oversight. Good financial management can be even more important if revolving funds rely on charges to other agencies for income and are not subject to competition because, under such circumstances, revolving fund managers may have less incentive to control costs. Sound internal controls and oversight by management are needed to ensure that revolving fund efficiencies are not neglected because costs can be passed on to its users. When external competition that can provide an incentive for cost-consciousness is absent and when fund acquisitions are expensive, revolving funds may need a greater degree of congressional oversight.

Second, for a revolving fund to be effective, the agency must be able to identify clearly the appropriate customers to charge and the actual capital cost that each customer incurs. If this is not possible, a revolving fund is probably not practical. For example, officials at the Coast Guard indicated that because of their organizational structure and overlapping missions it would be impractical for them to use a revolving fund. They explained that many Coast Guard assets are used by units in carrying out multiple activities—such as defense operations and law enforcement—so that it is potentially more difficult to assign cost to a specific mission or activity. They also stated that it would be inappropriate to charge some users of capital. Since mission responsibilities are often tied to carrying out search and rescue, law enforcement, and maritime environmental protection activities, fees attached to those activities could create perverse incentives. Coast Guard officials want to encourage units to use the most appropriate assets for carrying out their missions and not to be inappropriately influenced by cost considerations in what is often an emergency situation.

[9]For example, see Defense Business Operations Fund: DOD Is Experiencing Difficulty in Managing the Fund's Cash (GAO/AIMD-96-54, April 10, 1996).

Third, to be successful in the long-term, revolving fund managers must know their full costs and have the authority to charge fees that recover the cost of operating and replacing assets. Without replacement cost pricing, the resources of the fund would eventually be depleted by inflation. In addition, the accounting system of the agency must be able to track costs accurately. All agencies do not have adequate systems to allow them to fully allocate all costs associated with running a particular program or activity.

Fourth, to be self-sustaining, the revolving fund should be adequately funded initially and should receive additional resources when significant increases in its asset base are immediately required. If fees are established in order to meet a specific level of capital need, and that level increases, then some additional resources must be made available for the fund to remain self-sustaining. The additional resources could come from operational savings that are achieved, higher fees to users, or an external injection of funding (i.e., an appropriation). For example, IFMS must expand its service level to include more expensive, alternatively fueled vehicles but is hesitant to either delay vehicle replacements or raise rates and risk losing customers. IFMS officials believe that some of the cost can be funded through operating efficiencies but that additional funds will be necessary if the requirement cannot be modified. Likewise, if PBS must increase the size of its inventory to meet customer demand and past collections have not been designed to fund expansion, then appropriations may need to be considered. Existing reserves may be able to fund expansions of the asset base or service level in the short-term, but using these reserves would ultimately deprive the existing users from having their own assets repaired and replaced. Also, while providing a funding source for asset base expansion, increasing the fees charged to current users may make them pay more than the cost they are responsible for incurring, thus distorting the cost shown in the users' budgets. Conversely, if demand for the revolving fund's capital assets declines, resources could be taken out of the revolving fund to be used for other purposes across the government. This is especially the case for a revolving fund that purchases relatively large-scale and heterogeneous assets.

Fifth, if they are to provide a constant level of service, revolving funds typically need to have the flexibility to retain or dispose of assets based on their economic value and be able to reinvest the proceeds in the fund. If a revolving fund is to operate in a business-like fashion, its managers must be able to determine when it is more efficient to invest in new assets than to retain and operate existing assets. If revolving funds tasked with

providing constant levels of services are not able to dispose of under-performing or unnecessary assets and retain the proceeds, capital allocation decisions may be distorted. For example, PBS officials cited an experience where their financial analysis indicated that they should sell a building and use the proceeds to acquire alternative space. Although they could still use the building, in the long-term it would have been a more efficient use of resources to purchase new space. However, because PBS is prevented by law from keeping the sale proceeds, PBS retained the building.

Finally, revolving funds, like other funding mechanisms, must operate within an environment of controls if the Congress and OMB are to ensure that resources are well spent and that capital acquisitions reflect the government's highest priorities. Because revolving fund purchases need not be reviewed by the Congress or OMB, traditional revolving funds may not be appropriate when competition for the fund's services is lacking and when purchases are relatively large-scale, sporadic, or heterogeneous. Under these conditions, a greater degree of oversight is warranted to ensure that the resources accumulated in the fund are used where most needed governmentwide. Such assets might include buildings and courthouses acquired through the FBF. In contrast, revolving funds that compete with private-sector service providers and that make relatively routine purchases of small-scale, homogeneous assets such as vehicles, may warrant relatively high degrees of autonomy because the external factor of competition forces revolving fund managers to control their costs and effectively allocate resources.

An Investment Component Encourages Saving for Capital Needs

Another mechanism being used to ameliorate agency problems with up-front funding requirements is USGS' creation of an investment component within its working capital fund (WCF). The investment component is designed to encourage USGS managers to do better long-range planning for equipment purchases and to enable them to accumulate over time the resources they need to fund capital up-front. In this sense, the WCF investment component operates much like a savings account for a manager at any level to fund capital acquisition. In contrast to a more traditional revolving fund, users of the investment component make voluntary contributions for prospective capital purchases, rather than being charged retrospectively for capital usage. The investment component is a capital financing mechanism that could be useful for other agencies as well. However, expanded use must be accompanied by adequate controls on agency and governmentwide investment component

spending to ensure that funds are used as intended and to prevent increases in the deficit.

USGS Uses an Investment Account to Accommodate Up-Front Funding

USGS received authority from the Congress to expand its investment component within its WCF to assist in funding laboratory operations, facilities improvements, and replacement of scientific equipment beginning in fiscal year 1995. The investment component was proposed by USGS in response to difficulties experienced in obtaining appropriations for increasingly costly equipment. Over time, USGS had found that an increasing proportion of its annual appropriation was dedicated to fixed operating expenses, such as salaries and rent, with little left for funding long-term capital purchases. Furthermore, since USGS' appropriation was entirely one-year money—expiring at the end of the fiscal year—the agency was not able to accumulate unobligated balances over a number of years to use for occasional, expensive purchases.

To use the investment component, USGS managers at any level within the organization develop and submit an investment plan, which must be approved by a delegated authority within the respective division or the agency as a whole. The investment plan specifies the asset to be acquired, the estimated acquisition or replacement cost, the number of years required to fund the acquisition, and the schedule of deposits into the fund (annually, quarterly, or monthly, for example). After the investment plan is approved, the division periodically obligates the planned contribution amount from its annual appropriations and pays it to the investment component of the WCF, where it remains available for obligation. Once in the investment component, the contributions can be saved until a sufficient sum—as specified in the investment plan—has been accumulated to purchase the planned asset.

The USGS has imposed internal restrictions on the fund to prevent abuse of the authority. For example, the contributions must be made for at least 2 years prior to the purchase and may not be used for the construction of buildings. Once the plan is approved, contributions to the investment component are held for the specified purpose without fiscal year expiration.

Investment Components Offer Other Advantages and Limitations

Although it has little history thus far, the WCF investment component conceptually is a unique and useful way for individual agencies to plan for and finance capital assets. None of the officials we talked with at USGS,

OMB, or the House of Representatives Appropriations Committee, Subcommittee on the Interior, were aware of any other federal organizations using a similar financing mechanism. Nevertheless, the investment component has several benefits and may be a useful tool for other agencies, especially those with annually expiring funds. First, it encourages agencies to use long-range planning to alleviate the effects of up-front funding capital. Managers must anticipate the capital needs they will have in the future and submit a plan that indicates specifically how they expect to fund the asset need. An investment plan requires the agency to justify spending in advance of receiving the appropriations that will fund contributions. It also gives agencies an incentive to make their own trade-offs between operations and capital and to strive for savings in operations. The investment component achieves this by permitting agencies to set aside annual resources for future capital purchases. While agencies may have some incentive to look for savings in operations even without an investment component, the mechanism provides an impetus to make cuts in operations that may not exist otherwise.

A third advantage of the investment component is that it facilitates agencies funding their highest priority asset needs. When agencies do not have sufficient annual resources to make a particular capital purchase, they may be inclined to devote the resources to acquiring other—possibly less critical but less expensive—capital assets rather than see the funds expire at the close of the fiscal year. And finally, the investment component would contribute toward making program and operating budgets better reflect their cost of capital usage. The investment component will not be as efficient or accurate at allocating capital costs as a revolving fund since it lacks the direct linkage between capital use and charges. However, because contributions are made from the operating budget, the mechanism does help facilitate a more systematic incorporation of capital costs into program expenses.

Despite the potential benefits from investment components, problems could arise if investment accounts were widely used throughout government without adequate controls. For example, if several agencies obtain investment components and each decides to make large purchases in the same year, total outlays could rise sharply and cause a spike in the deficit. Therefore, OMB will need to manage all investment components to ensure that the total investment component outlays do not cause such spikes, even though this may result in deviations from the schedule specified in the agency's original investment plan.

Furthermore, if the Congress permits agencies to use such investment components, it is giving them relatively more control than they currently possess over the use of their appropriation. Investment component control issues are similar to those of revolving funds (discussed previously in this chapter); thus the Congress would need to have similar confidence in the financial management abilities of agency officials before it permits the establishment of an investment component. Once established, managers should prepare and be held accountable to investment plans to ensure investment component funds are used as intended.

The investment component concept is premised on program managers being able to plan for fixed asset acquisitions by accumulating funds over a period of years and applying them toward a future capital need. USGS officials felt that potential congressional actions to re-allocate these funds, such as rescissions and reductions in future appropriations, would create significant disincentives for managers to contribute. Likewise, these officials felt that program managers would be less likely to contribute if top-level management used contributions for purposes other than those in the investment plan.

Though a promising tool, the investment component can have limitations to its usefulness. Agencies already faced with tight operating budgets may have little to contribute to such an account without making difficult trade-offs with operations, potentially including personnel cuts. Although increasing numbers of agencies have been confronted with downsizing in recent years, some appropriations subcommittee staff still question the willingness of agencies to voluntarily trade-off personnel for capital assets. Furthermore, capital assets must still be budgeted for in advance of any savings they may generate. Capital acquisitions that could "pay for themselves" over time still could not be funded without the agency first carving out funds from elsewhere to pay for them. In an era in which agencies are already faced with budgets that require significant cuts in operations, it is unknown how much willingness may exist among agency heads to exact even deeper cuts in order to fund capital.

Agencies Can Reduce Their Need to Own Assets

Another way that case studies have dealt with the up-front funding requirement is to take actions that reduce their need to own fixed assets. Two of these strategies include contracting out for goods and services and cooperative arrangements to share assets. For example, officials from the Corps of Engineers have indicated that some functions for which they formerly acquired capital assets—such as producing crushed

aggregate—can now be performed by the commercial market at less expense. It is likely that in other agencies as well, government managers have found that increasing specialization among contractors enables agencies to acquire some capital-intensive services more cheaply externally than they can be performed in-house. Contracting out can be useful and cost-effective when asset needs are short-term and non-recurring. However, agencies still incur expenses to monitor contractor performance, and contracting out can be misused to by-pass budget scoring rules for purchases. When the latter occurs, the long-term cost of contracting out can be higher than directly purchasing the asset.

Where practical, USGS has entered into long-term cooperative arrangements with universities and states to share the purchase and use of capital assets that are not needed full-time. Under such arrangements, USGS uses the equipment as needed without bearing the full costs of ownership. Although this arrangement has little fiscal drawback, USGS officials did indicate that some federal requirements for physical tracking of the property are harder to comply with when the assets do not reside at USGS facilities.

Operating Leases Offer Flexibility but Can Be More Costly

Purchasing is only one of several ways in which agencies may acquire capital assets. Agencies may also use various forms of leases to meet asset needs. The three primary types of leases are operating leases, capital leases, and lease-purchases.[10] Each represents a different degree of risk and financial commitment borne by the government and budget scoring rules are designed to reflect these differences. Operating leases offer agencies the greatest flexibility with the least risk and financial commitment. For short-term needs, operating leases can be the most cost-effective means of acquiring capital assets. However, because of resource constraints and more favorable budget scoring rules, some agencies have substituted operating leases for more cost-effective means of meeting long-term needs. A refinement in the definition of operating leases may be needed in order to assure consistent application of the up-front funding requirement and better comparisons of financing options.

[10]For the purposes of scoring leases in the budget, operating leases and capital leases differ from lease-purchases in that the ownership of the asset is not transferred to the lessee at the conclusion of the operating or capital lease period. Operating leases are distinct in that they are generally for shorter-term needs and all risks of ownership of the asset remain with the lessor.

Agencies Use Operating Leases Because of Lower Up-Front Cost

Analyses have shown that ownership of capital assets is generally the most cost-effective method for meeting long-term capital needs.[11] However, differences in budget scoring can sometimes affect an agency's selection of an acquisition method. Budget authority and outlays for purchases and lease-purchases where the government assumes substantially all risk, must be scored up-front, regardless of when the actual outlays occur. Budget authority for capital leases is scored up-front with outlays scored over the lease period. These scoring conventions were adopted to recognize the full extent of the government's commitment and to facilitate comparisons of the long-term cost of the various financing methods. Operating leases, in contrast, are intended primarily to meet short-term capital needs. Budget authority and outlays for operating leases are scored over the lease period in an amount equal to the annual lease payments. Because of these budget scoring conventions, however, a long-term operating lease will require considerably less budget authority during the initial years than would a capital lease or a lease-purchase of the same duration. This difference in up-front cost, coupled with resource constraints, has led some agencies to use operating leases to meet long-term needs—even though the long-term cost of such leases is projected to be higher.

Officials at PBS indicated that their organization has frequently used operating leases to acquire office space when budget resources were inadequate for purchases. PBS officials have been faced with customer demands for long-term office space that exceed that which PBS can purchase given its available budget resources. As a result, PBS has entered into operating leases in order to meet agency demands for space. Although such leases could be used as an interim measure until such time that a purchase is possible, in many cases the leases have become a more expensive, long-term solution to agency space needs.

IFMS officials indicated that they have also used operating leases in lieu of purchases when budget resources were insufficient. IFMS' take-over of the management of the Department of Defense's (DOD) fleet of vehicles placed additional demands on the resources of the IFMS. IFMS determined that sufficient resources were not available to fund replacement of the DOD vehicles and so turned to operating leases as a means to acquire new, more cost-effective vehicles for DOD until funds could be accumulated in the revolving fund for purchases. IFMS officials believe that vehicle purchases would have been more cost-effective but that leases were

[11]See for example Federal Office Space: Increased Ownership Would Result in Significant Savings (GAO/GGD-90-11, December 22, 1989).

needed to meet immediate customer needs when budget resources were not available.

Some case studies did not consider operating leases to be a viable alternative to ownership because the assets they acquire tend to be somewhat specialized. To the extent that the commercial market for the asset is small, it is less likely that leasing will be feasible. For example, Coast Guard and USGS officials said that leasing ships and some scientific equipment, respectively, were not viable options for meeting their capital needs. These officials generally indicated that purchases are the most cost-effective method of acquiring capital assets for their organizations.

Budget Scoring of Long-Term Leases Should Reflect Their Total Cost

Operating leases can provide an important measure of flexibility to agencies to meet short-term capital needs without incurring the cost and long-term obligation of ownership. For federal office buildings, factors such as governmentwide downsizing, changing conditions in the real estate market, and uncertainty about agency missions all make operating leases a valuable tool for the federal government to manage its asset requirements in the face of uncertainty. PBS has maintained that part of its portfolio should be in the form of leased space in order to preserve a degree of flexibility to respond to changing needs. It is important that operating leases have a budgetary treatment that allows them to be available to meet genuine short-term needs. However, deficiencies in the current budget scoring rules have resulted in an over-reliance on operating leases and need to be rectified. Previously, we have noted that applying the principle of up-front full recognition of the long-term costs to all options for satisfying long-term space needs—purchases, lease-purchases, or operating leases—is more likely to result in selecting the most cost-effective alternative than applying the current scoring rules.[12]

Operating leases were not intended to be used as a substitute for ownership. When operating leases are used to meet long-term needs, the total cost of the project decision—spread over many years as lease payments—is understated in the first-year's budget. When operating leases are used to avoid up-front budget scoring, the agency may be using a financing method that is more costly in the long-run. Ideally, budget scoring should be neutral in its effect on decision-making. However, current scoring rules are driving some decisions to use operating leases. For space acquisition, neutrality would be better accomplished by

[12]Budget Issues: Budget Scorekeeping for Acquisition of Federal Buildings (GAO/T-AIMD-94-189, September 20, 1994).

recording in the budget the long-term cost of space regardless of the type of financing.[13] If this is done, the agency's decision-making about which financing option is used would be driven by what makes the most sense economically and programmatically, not by what scores most favorably in the budget.

PBS officials have suggested that there would be less need to use more expensive operating leases if budget authority for lease-purchases was still scored over the term of the lease, as it was prior to BEA. However, the change in scoring for lease-purchases was necessary to recognize the full commitment of the government and to ensure compliance with the requirement of up-front funding. The budget now recognizes the higher cost typically associated with lease-purchases compared to direct purchases. Officials at OMB stated that some operating leases currently in use for long-term needs are really more like capital leases because the buildings have been or will likely be leased for the bulk of the asset's life. They indicated that such leases ought to have budget authority scored up-front. Although it may be difficult for policy makers to know for certain when a capital need will be long-term, some OMB officials believe that a tightening of the definition of an operating lease is warranted to ensure that the budget process leads to better economic decisions.

Case Studies Seek Additional Tools for Responding to Up-Front Funding

Officials at some case study organizations indicated that they would be able to better meet their capital needs and the requirements of up-front funding if they had additional financing tools available. IFMS officials, for example, believe that authority to borrow from the Treasury against the value of the fleet would help them manage resources more efficiently. Similarly, PBS officials desired authority to borrow against future rental income to finance space acquisition. On the other hand, legislation has been enacted that would allow the Coast Guard to offer loan guarantees and to enter into limited partnerships with nongovernmental entities in order to finance construction of employee housing without bearing the full cost up-front.[14] Officials at OMB and the appropriations subcommittee staffs expressed concern that allowing agencies to borrow against their assets would pose a threat to governmentwide fiscal control by permitting agencies to create budget authority without receiving appropriations. These officials had mixed opinions about the Coast Guard's loan

[13]For additional discussion of the need for this scoring change and the challenges in implementing it, see Budget Issues: Budget Scorekeeping for Acquisition of Federal Buildings (GAO/T-AIMD-94-189, September 20, 1994).

[14]P.L. 104-324, enacted October 19, 1996.

guarantee and limited partnership proposals and believe that further information would be needed to evaluate their soundness. We agree with their conclusions.

Borrowing Authority Is Sought by IFMS and PBS

An IFMS official stated that current budget rules do not lend themselves to the efficient financial management of business-oriented revolving funds, and that IFMS would like to manage its revolving fund on a "balance-sheet basis" instead. The official stated that limiting the revolving fund's obligations to those that can be made with the unobligated balances of its budget authority constrains capital spending when balance sheet analysis would suggest that the fund possesses highly liquid resources that could be made available to fund capital acquisition. Managing on a balance sheet basis means that budgetary resources would be re-defined to include the book value of vehicles. Allowing IFMS to manage on a balance sheet basis would be comparable to giving it a line of credit or authority to borrow from the Treasury. This would enable IFMS to purchase vehicles when expanding the fleet, rather than using more costly operating leases. The IFMS official indicated that, in general, authority to borrow would enable them to hold lower cash balances and to manage the fleet in ways that more closely parallel those of private-sector rental car companies.

PBS would also like to use borrowing authority to fund capital assets. One PBS official noted that although PBS is often compared with private-sector real estate providers, PBS lacks the financing tools the private sector uses to manage efficiently. For example, private-sector real estate companies can borrow against the value of their long-term leases, but PBS cannot. If PBS could borrow from the Treasury to finance a purchase, PBS officials believe that budgetary resources spent on operating leases could instead be used to repay the mortgage—and at less cost to the government in the long-run. PBS has found that lease-purchases can be more cost-effective in the long-term than operating leases and had used them prior to BEA to finance asset acquisition over time. Borrowing from the Treasury would enable PBS to do the same but at lower cost.

Permitting agencies to borrow against the value of their assets is, in effect, allowing them to create budget authority, thus diminishing congressional control and oversight. Officials at OMB and appropriations committee staffs felt that such a practice would inhibit control of total federal expenditures and increase government borrowing. Officials also expressed concern about the consequences if an agency were unable to repay a loan from rental collections and was forced to sell agency assets to make

repayments. While the sale of a vehicle raised less concern than the sale of a building, officials felt that regardless of the asset in question, the practice would be difficult to control. The Congress could also be forced into making an appropriation in order to compensate for the shortfall in income.

With regard to PBS specifically, OMB examiners felt that the resources going into the FBF were adequate to meet PBS' needs—given government downsizing and the moratorium on new office space construction. They indicated that if there are needs that cannot be met with the available resources—possibly courthouse construction—the agency should request an appropriation, and that request should compete with other budgetary options. If PBS' request is not funded, it reflects the fact that OMB and the Congress have established higher priorities elsewhere. Borrowing authority should not be used to circumvent the appropriations process. While PBS, unlike the private sector, may not borrow against the value of its assets, it does receive financing through appropriations. An appropriation would be viewed as a gift in the private sector since it does not have to be repaid nor is it required to produce returns to investors.

The Coast Guard Received Authority for Equity Partnerships and Loan Guarantees

Recently enacted legislations gives the Coast Guard authority to enter into certain financial arrangements with private-sector developers.[15] This authority, modeled after similar legislation enacted for DOD,[16] provides a variety of tools for the Coast Guard to draw upon. These new tools include authority to enter into limited partnerships and to offer loan guarantees. Each of these could be used as an inducement for private developers to construct housing in remote locations. By underwriting the cost to the developer, Coast Guard officials believe that housing can be obtained for considerably less than if the Coast Guard were to build it directly.

Under the equity partnership arrangement, the Coast Guard would pay up to one-third of the cost rather than the full cost of construction.[17] An early DOD's proposal implied that under this arrangement the developer would receive no rental guarantees but would recoup its investment through rent paid by employees and members of the general public who use the facilities. The government would also be repaid its investment through

[15]P.L. 104-324, enacted October 19, 1996.

[16]P.L. 104-106, enacted February 10, 1996.

[17]If land or facilities are conveyed as part of the project, the Coast Guard's total investment may not exceed 45 percent of the project's cost.

rental charges. Under the loan guarantee program, the Coast Guard would guarantee loans made to a developer if the proceeds are used to acquire or construct certain Coast Guard housing. Coast Guard officials believe that guarantees could be necessary because of the perceived risk by lenders that the Coast Guard will not be in an area long enough for the developer's loan to be repaid. Under both of these methods, Coast Guard officials believe they also save by having private developers provide the housing and avoiding expenses that would be incurred complying with construction regulations for federal projects.

OMB analyzed the scoring implications of the original DOD proposal in May 1995. This analysis suggested that with equity partnerships, only the government's equity investment would be scored up-front. It also suggested that only the subsidy cost of the loan guarantee program would be scored up-front. However, more recent discussion with OMB officials has raised questions about whether such arrangements resemble capital leases, and therefore whether a different scoring would apply. An OMB official also suggested that because Coast Guard housing is often in more remote areas than DOD's, the authority may be less suitable for the Coast Guard than it is for DOD. Where the Coast Guard is virtually the only user of the property, the arrangement more closely parallels a capital lease than an operating lease. This is because there is no private-sector market for the housing and the Coast Guard is providing financing mechanisms that presume it will occupy the housing for more than 75 percent of its economic life. Both of these are key features of a capital lease. It is clear that more detail would need to be available about any specific agreements before a definitive conclusion can be drawn about the appropriate scoring of these proposals or their economic value to the government.

Certain Mechanisms Enabled Case Studies to Deal With Other Capital Spending Impediments

In addition to up-front funding, case studies found other features of the budget process and their accounts impaired their ability to acquire capital. Uncertainty over future missions and funding levels, account features that affect trade-offs between operating and capital needs, and constraints on the use of proceeds from asset sales may be impediments from an agency's perspective. However, the Congress needs flexibility to ensure that the government's overall spending decisions reflect the nation's current priorities. Our case studies illustrate that a variety of strategies are available to mitigate impediments for agencies without diminishing opportunities for congressional oversight or flexibility to change funding levels.

Case Studies Find Various Tools Useful for Managing Changes in Missions and Funding Levels

The Congress and the administration must continually assert control over agency planning and funding decisions to ensure that the nation's priorities are met. Changes in missions and funding uncertainty are inevitable and justifiable if the Congress is to respond to the nation's priorities. However, such changes make planning and conducting cost-effective capital acquisitions more difficult for case study managers. Our case studies used mechanisms discussed previously, such as revolving funds and budgeting for stand-alone stages, as well as reprogramming authority, to respond to changes in their political and fiscal environments while preserving Congress' ability to direct such changes and oversee agency responses.

Changes in Missions and Funding Uncertainty Can Hamper Capital Planning

The Congress cannot guarantee steady annual funding streams (beyond that provided for stand-alone stages) if it is to be responsive to changing priorities and resource levels, but the prospect of mission or funding changes can increase the difficulty associated with planning and managing multiyear or risky capital purchases. For example, the Corps can successfully plan cost-effective construction projects only by assuming future funding levels. However, if planned funding fails to materialize, the Corps may have to deviate from these plans, and the project may become more expensive than estimated.

Uncertainty over future responsibilities and funding can affect less expensive capital acquisitions with shorter completion times too. For instance, USGS officials speculated that managers may not feel comfortable committing to future WCF contributions for equipment purchases when they cannot predict how much of their future budgets these contributions will absorb. USGS officials also suggested that managers may be reluctant

to contribute to the WCF if they believe the Secretary of the Interior might use contributions to meet other priorities.

Funding delays or shortfalls can also affect agencies' abilities to design effective and efficient fixed asset procurement. Although such delays may be warranted by the emergence of higher priorities, the cost of the postponed project is likely to increase. For example, the Coast Guard structures its acquisition strategies to assure contractors of minimum levels of production that will keep costs low. In their response to OMB Bulletin 94-08, Coast Guard officials wrote that funding that is insufficient to support acquisition strategies or rescissions can cause contractor shut-downs and make designs obsolete, adding to projected costs. For example, the response says that, when acquiring the HH-60 helicopter, the Coast Guard paid a premium of $1 million to $2 million per aircraft because funding was not provided to purchase a number of aircraft that would enable the contractor's production line to operate efficiently. FDA officials said they have been reluctant to fund repairs and maintenance on some current work space because of the agency's planned consolidation into fewer locations. They also stated that FDA will incur expensive repairs if the existing space continues to be used.

Some Tools Balance Agency Flexibility With Congressional Control

As noted previously, revolving funds can provide a steady and secure stream of funding and encourage long-term planning for capital acquisitions while allowing opportunity for some congressional oversight. For example, by recovering depreciation and an inflation increment from users over an asset's useful life, the Corps' revolving fund helps ensure that funds will be available to replace the asset when needed and that program budgets absorb the cost of capital. Consequently, managers must plan what and when acquisitions will be made in order to maintain a self-sustaining revolving fund. However, the Corps' appropriations subcommittees exercise oversight responsibilities by approving every revolving-fund, fixed-asset acquisition of $700,000 or more and implicitly approving all acquisitions through an annual target on revolving fund obligations for capital assets.

When agencies experience changes in mission or funding needs, reprogramming[1] can be used to move funds between projects. Because funds are appropriated for specific purposes, the Congress wants to know when substantial deviations from the intended use of funds are made or when needs no longer exist. Therefore, the Congress may place limits on the amount of reprogramming that can be done without its prior approval. In certain situations, these limits may be necessary if the Congress is to provide effective oversight.

Reprogramming can be an effective management tool if used as intended by the Congress. Reprogramming authority allows funds to flow to new priorities or can help complete projects when actual costs exceed original estimates. For example, the Corps revolving fund has used reprogramming authority to accommodate fluctuations between anticipated and actual bids of contractors on fixed asset acquisitions. Up to 10 percent of the funds within the Corps' fixed asset categories can be diverted from one acquisition to another without prior approval by the Corps' appropriations subcommittees. When reprogramming requires the subcommittees' approval, informal relationships between Corps officials and congressional staff help the Corps receive a quick response to reprogramming requests. The Coast Guard has also taken advantage of reprogramming authority to respond to variances between estimated and actual costs for construction projects. Nevertheless, Coast Guard officials feel they are constrained in addressing some new and changing priorities because of limits on their reprogramming authority. (The Coast Guard needs its appropriations subcommittees' approval to reprogram more than the lesser of $1 million or 15 percent of the total amount appropriated for a project and cannot reprogram between categories of appropriations in the Acquisition, Construction, and Improvements account (AC&I).) Officials at Coast Guard and NOAA expressed concern about the time involved in seeking reprogramming authority. Some of the time involved in reprogramming is due to obtaining approval within the agency, and it is unclear to what extent agencies inhibit use of reprogramming by designing cumbersome, internal procedures for requesting the authority.

Agencies can also attempt to manage funding uncertainty by dividing multiyear capital projects into stand-alone stages that can be acquired and

[1]Reprogramming is the shifting of funds from one object or program to another within an appropriation or fund account for purposes other than those contemplated at the time of appropriation. As a matter of law, an agency is free to reprogram unobligated funds as long as the expenditures are within the general purpose of the appropriation and are not in violation of any other specific limitation or otherwise prohibited. While there are no governmentwide reprogramming guidelines, the Congress exercises control over an agency's spending flexibility by providing guidelines or nonstatutory instructions on its authority to reprogram.

budgeted for separately. For example, Coast Guard acquisitions are sometimes structured as a base-year contract for a limited quantity of items with options to buy between a minimum and maximum quantity in future years. This structure permits the contractor to produce economically while acknowledging the inherent uncertainty of future funding levels. This acquisition strategy does not ensure that multiyear acquisitions will be completed as planned but attempts to balance agency desires for certainty with the Congress' responsibility to allocate resources in a changing environment. With this strategy, the Congress indicates an initial agreement to the total purchase but still has the prerogative to fund less than the minimum quantity.

Account Features Affect How Trade-Offs Between Capital and Other Expenditures Are Made

Various features of an account—its congressional and executive review structures, its purpose, and the period for which its funds are available—can affect an agency's ability to justify and make effective capital purchases. Each can influence how lawmakers view the trade-offs between types of capital spending or between capital and operations spending. Where certain account features seemed to discourage what case studies perceived to be prudent capital decisions, case studies sought other features, such as longer periods of funding availability and separate appropriations accounts for capital. Although certain account features may facilitate justifying or executing fixed asset purchases, case study officials stated that some types of asset purchases tend to be more difficult to support regardless of an account's features. As a result, case studies have developed strategies unrelated to account features, such as more comprehensive budget justifications, to better explain capital needs.

Congressional and Executive Review Structures May Affect Consideration of Capital Expenditures

Congressional committee jurisdictions and executive organizational budget review structures have developed over time to fulfill a variety of needs and purposes. When these are different, a competitive conflict could arise. For example, FDA faces two different sets of competitors in the budget process. OMB includes FDA's budget within the spending cap applied to FDA's parent agency, the Department of Health and Human Services (HHS), even though FDA is not funded by the same appropriations subcommittee as HHS. As a result, during the administration's budget formulation, FDA competes against other HHS programs which are not reviewed by FDA's appropriations subcommittee. The difference in executive and congressional review structures might result in a proposed capital project being eliminated under one set of competitors when it might have survived amongst another set.

Purpose of Account Affects Justification of Capital Expenditures

Some capital expenditures can be more difficult to justify when funded from an account whose primary purpose differs from that of the capital spending request, such as a salaries and expense account that funds mostly operational expenditures. Most capital spending across the government occurs from accounts whose primary purpose is to fund capital assets. However, where dual-purpose accounts exist, they can distort the cost of capital in the budget year relative to other expenditures or affect perceptions of the capital spending's acceptability. Dual-purpose accounts can also result in operating expenditures obscuring capital needs in some instances.

Distortions in the Cost of Capital

Capital projects funded in accounts comprised largely of operating activities may seem more expensive than capital projects funded in other types of accounts in the budget year. This occurs because, when scoring outlays, accounts that contain mostly salaries and operating expenses have a first-year spend-out rate[2] closer to 100 percent when capital expenditures have historically been a relatively small or sporadic component of the account's spending. Conversely, accounts that have traditionally funded mostly capital expenditures receive a low, first-year spend-out rate that reflects the typical multiyear pattern of construction cash flows. For example, the Coast Guard's Operating Expenses account has a first-year spend-out rate of 80 percent; the AC&I account has a first-year spend-out rate of 17 percent. When outlay constraints are tight and capital is a relatively small or nonrecurring expense, capital expenditures funded in operating accounts may yield higher first-year outlay estimates than capital expenditures in capital accounts and, therefore, may be less likely to be funded.

On the other hand, the use of predominantly capital accounts with lower first-year spend-out rates can protect new construction when budgetary cuts are being made. A new $100 million construction project makes fewer outlays in the first-year, and thus can produce fewer outlay savings in that year, than a $100 million operating account. Therefore, a much larger amount of new construction budget authority would have to be cut to achieve a given amount of outlay savings than if operating funds were cut. Accordingly, when outlay savings are needed, capital accounts may have an advantage over operating accounts.

Spend-out rates may also potentially affect the trade-offs between different types of capital expenditure when they are funded out of the

[2]A spend-out or outlay rate is the ratio of outlays resulting from new budgetary resources to the new budgetary resources in a given fiscal year.

same accounts but outlay at different rates. For example, PBS funds all capital expenditures from the same account, but each type of expenditure has a different outlay rate. Purchases of existing buildings have a 100 percent first-year outlay rate, repairs and alterations have a 20 percent rate, and new construction a 3 percent rate. The remaining outlays for repairs, alterations, and construction will be scored in subsequent years. While many factors, including future years' outlays, affect how capital is acquired, outlay scoring would appear to make new construction considerably more attractive than buying an existing building. Though market conditions may make the purchase of existing buildings more economical than constructing new ones, the outlays of the former will be higher in the budget year. Likewise, repairs and alterations can initially appear more expensive than new construction. Extensive budget justifications showing the most effective use of capital are particularly important in such cases.

Perceptions of Acceptability

The purpose of the account may also affect perceptions of the acceptability of capital expenditures. A congressional staff member explained that recent Treasury secretaries may have been reluctant to request funding to repair the Treasury building. The staff member opined that because such repairs would traditionally be funded from the Office of the Secretary's discretionary budget account, the secretaries may have believed they would be criticized for increasing their office budgets. To make the purpose of the funding more readily apparent and to achieve a lower first-year spend-out rate for the repairs, the subcommittee created a separate account for Treasury repairs and maintenance in Treasury's fiscal year 1996 appropriations act. Separate repairs and maintenance accounts were also created for the White House and the National Archives.

Obscured Capital Needs

Placing operating and capital expenses in a single account may help simplify oversight and can encourage agencies to take the initiative in making trade-offs between capital and operating expenditures. However, such dual-purpose accounts can hinder agencies' capital requests when operating expenses are large enough to obscure capital needs. For example, USGS justifies the budget for its Surveys, Investigations, and Research account by program. Program line items generally represent USGS activities, such as water resources investigations, rather than the types of items USGS would like to fund, such as fixed assets. USGS officials believe this budget structure hides the increasing cost of scientific equipment by combining these expenditures with large program operating costs.

Although combining capital and operating expenses in one account may hide some capital needs, agencies have other means to illuminate them. Budget justifications can be used to highlight capital needs and costs of alternatives if capital is not visible in the account structure. To help emphasize capital needs, USGS created a separate "digital mapping" modernization line item in its budget justification. In another instance, USGS explained to the Congress that leasing a mainframe computer would cost over 20 percent more than purchasing.

Other case study officials feel separate capital accounts are needed to protect or raise the visibility of capital. The Coast Guard stated that its dedicated capital account has helped mitigate a crowding out of fixed asset acquisitions and has focused attention on capital. OMB proposed that PBS' construction and acquisitions be placed in an account separate from the FBF to highlight the magnitude of these needs and to prevent them from crowding out repairs and alterations.

However, a separate appropriations account for agency capital may inhibit collection and knowledge of the total costs of each of an agency's programs. If capital appropriations are not charged back to managers' budgets, capital may seem inexpensive and, thus, be used inefficiently. Segregating capital into a separate appropriation account may also discourage trade-offs between related capital and operating spending. However, such trade-offs can be promoted by the use of separate revolving funds for capital assets. Rather than relying on appropriations, revolving funds charge program managers for their use of capital assets, as discussed in chapter 3.

Length of Fund Availability Affects Agencies' Ability to Make Capital Acquisitions

Some agencies are able to justify acquisitions but may have difficulty executing them when funds expire before projects can be completed. Multiyear and no-year funding help agencies accommodate capital's longer acquisition cycle. For example, Coast Guard and Corps construction projects generally need multiyear appropriations because their acquisition cycles can last several years. No-year funding is commonly provided through revolving funds. Through charges to users, revolving funds convert annual or multiyear appropriations into no-year funding that an agency can accumulate for large-scale acquisitions. All of our case studies had the opportunity to fund capital through multiyear appropriations or a revolving fund. However, even with multiyear funding, the period of availability may not always be appropriate. For example, the Congress and the Coast Guard have had difficulty agreeing on the period of fund

availability that is long enough to complete the agency's projects and short enough to discourage delays.

The Congress has been fine-tuning the Coast Guard's fund availability over the last several years. For fiscal year 1992, the Congress shortened the availability of shore, other equipment, and aircraft funds from 5 to 3 years to encourage quicker completion of projects. The House of Representatives Committee on Appropriations, Subcommittee on Transportation, reasoned that Coast Guard's funding availability should be patterned after an agency that makes similar acquisitions, DOD, especially since DOD's acquisitions are generally more complex. However, on some occasions in the past, Coast Guard officials have found it difficult to obligate funding for shore facilities within 3 years. Because shore projects are sometimes linked to vessel projects which have 5-year availability, vessel design changes could delay the obligation of shore funds. If a vessel project were delayed too long, funding for completion of the related shore facility could expire. In cases where the timing of one project affects another, it is important for the affected agency to work with its appropriations subcommittee to ensure that funds are available during the period needed.

In addition, agencies with one-year appropriations cannot annually set aside and accumulate funds needed to make expensive fixed asset acquisitions. Prior to creating a WCF investment component, USGS had to fund all capital acquisitions with annually expiring appropriations. USGS had no ability to spread the cost of an expensive purchase over a number of years by saving some funds each year. Without a significant increase in appropriations, only relatively inexpensive purchases could be made.

The Congress can maintain control over no- and multiyear funding through a variety of means. For example, the Congress encourages timely completion of projects and exercises control over the Coast Guard's multiyear appropriations by requiring quarterly reports of progress on major acquisitions and by sometimes limiting funding of projects to stand-alone stages. Recent legislation may also help the Congress oversee the use of no- and multiyear funding governmentwide. The Federal Acquisition Streamlining Act requires that executive agency heads (1) set cost, performance, and schedule goals for major acquisition programs, (2) monitor the programs to ensure they are achieving, on average 90 percent of the established goals, and (3) take corrective actions, including termination, on programs that do not remain within the

permitted tolerances. FASA also requires OMB to report to the Congress on agencies' progress in meeting these cost, schedule, and performance goals.

Agencies Believe Some Capital Expenditures Are Inherently More Difficult to Justify

Regardless of any account features that affect capital—congressional or executive review structures, purpose, or period of availability—case study officials felt capital expenditures with less visible benefits are inherently more difficult to justify. Explaining the costs and benefits of less tangible assets is difficult, and the Congress may have more difficulty understanding the explanation. The Coast Guard and NOAA indicated that needs for visible, safety-related assets are easier to articulate than needs for information technology or research projects. Congressional staff generally agreed but noted that agencies sometimes poorly explain the need for information technology. Congressional staff acknowledged that spending for assets with visible and tangible benefits, such as new construction, may be favored over less visible assets, such as major modernization or repairs. However, some staff also perceived agencies as being unwilling to cut personnel costs to free funds for capital in general.

Agency problems in justifying assets with administrative or intangible benefits emphasize the importance of adequate budget support for all capital asset acquisitions. Such support should include risk and cost-benefit analyses of alternative acquisition methods and show scenarios of long-run spending under various operating and capital spending levels. Inherently risky or intangible assets may require the agency to provide additional documentation or presentations to their appropriations subcommittees.

Asset Sales Questions Pit Managerial Autonomy Against Congressional Control

Agencies and the Congress tend to take different sides on the question of whether agencies should retain proceeds from the sale of their assets. Officials at our case studies feel the ability to keep proceeds can provide the incentive needed to dispose of properties that are no longer needed or costly to maintain. Therefore, they would like to reinvest disposal proceeds in maintenance or acquisition of new assets. Some in the Congress are concerned that agencies might use asset sales as a means of skirting the appropriations process. Despite these concerns, the Congress allows some agencies, especially those with revolving funds, to retain asset sale proceeds. Our case studies illustrate that allowing agencies to retain disposal proceeds may be warranted under limited circumstances.

The Congress Determines Whether Agencies Can Retain Proceeds From Asset Sales

The Congress has selectively determined which organizations or funds can keep disposal proceeds. Some revolving funds, such as those of the Corps and IFMS, are permitted to retain asset sale proceeds; but some, such as that of PBS, are not. Where assets have been acquired through appropriations, such as at the Coast Guard, agencies have usually not been permitted to keep sales proceeds. Whether they have revolving funds or receive appropriations, our case studies cite the inability to retain disposal proceeds as an impediment to capital acquisition and a disincentive for asset disposal.

PBS officials cite the inability to obtain and keep proceeds from the sale of GSA properties as one factor that keeps the FBF from being self-sufficient. Any proceeds from asset sales must be deposited into a land and water conservation fund.[3] PBS officials indicated that this can create a disincentive to dispose of less cost-effective properties. The other revolving funds operated by our case studies can retain disposal proceeds and have fewer restrictions on disposal of assets. Although the Corps considers disposal proceeds a minor source of funding, IFMS relies heavily upon proceeds from the sale of vehicles to sustain operations and keep rates competitive with the private sector.

Similarly, Coast Guard officials were supportive of recently enacted legislation that allows the agency to keep proceeds from the sale of housing and reinvest them in maintenance or new housing. Coast Guard officials say the agency's employees have difficulty finding affordable, local housing to rent in remote or resort areas and, therefore, the Coast Guard often needs to construct housing for them. The Coast Guard would like to be able to enhance its ability to meet new construction and repair needs by disposing of less important or less cost-effective properties and investing the proceeds in higher priority areas. Currently, the Coast Guard generally cannot dispose of one property in order to invest in another unless specifically provided by law.[4] When housing property has been disposed of, proceeds have been returned to the Treasury.

[3]The same law also prevents PBS from retaining income from leases to non-federal entities.

[4]The Congress has occasionally allowed agencies to credit asset sales proceeds toward their appropriations. For example, the fiscal year 1997 Transportation Appropriations Act permitted the Coast Guard to retain proceeds from surplus real property sales during the year, although it did not designate specifically how the proceeds would be used. This Act also authorized the Coast Guard to retain proceeds from the sale of certain aircraft and use the proceeds to acquire new aircraft and increase aviation capacity.

Recently enacted legislation[5] establishes a Housing Improvement Fund for the Coast Guard. Appropriations and proceeds from the sale or lease of Coast Guard property or facilities would be deposited into the fund. The Coast Guard would be authorized to use the fund for acquiring housing to the extent provided in appropriations acts. If the Coast Guard is expected to maintain a constant level of housing, this authority appears appropriate because the Congress retains control and oversight, and proceeds can be used to reduce future appropriations requests.

Circumstances May Justify Some Agencies Retaining Proceeds

The Congress permits most agencies with revolving funds to keep proceeds from the disposal of assets but generally does not allow agencies that finance capital from appropriations to retain disposal proceeds. This dichotomy occurs because revolving funds are established for the business-type activities of the federal government and must retain some business-like tools if they are to be self-sustaining. Prohibiting a revolving fund from retaining disposal proceeds may impede the fund's ability to cover all of its costs and encourage fund managers to seek additional sources of financing, such as appropriations or increased user charges. In contrast, agencies that acquire capital with appropriated funds do not retain disposal proceeds under most circumstances because they are expected to request appropriations for regular maintenance and replacement of assets.

Under some conditions, revolving funds may not need to retain proceeds from the sale of assets. If a fund no longer needs to replace some assets, because of agency downsizing, for example, the proceeds may be more appropriately returned to the Treasury to reduce federal borrowing or to fund other needs instead of being spent by the fund. If the proceeds are relatively large, the Congress may wish to weigh the needs of the fund with the needs of other activities that could benefit from additional funding.

[5]P.L. 104-324, enacted October 19, 1996.

OMB's Effort to Improve Planning and Budgeting for Fixed Assets

In July 1994, OMB began an effort to identify issues related to planning and budgeting for fixed assets. This effort was spurred, in part, by National Performance Review (NPR) recommendations aimed at improving fixed-asset planning and budgeting.[1] OMB requested information regarding agencies' fixed-asset needs and concerns and used that information to assess governmentwide and agency-specific planning and budgeting practices. Responses to OMB's request, which varied in completeness, revealed that agencies were using a variety of practices to plan and budget for fixed assets. The responses also provided OMB with insights into issues of concern, such as up-front funding. Up-front funding became the focus of OMB's follow-up effort in 1995. As a result, the President proposed, for fiscal year 1997, full funding for several new and ongoing capital projects that otherwise would have been incrementally funded. For the fiscal year 1998 budget, OMB is requiring that agencies request full up-front funding for all capital acquisitions and that agencies show how their capital plans relate to the goals and plans of three performance-related initiatives—GPRA, the Federal Acquisition Streamlining Act of 1994 (FASA), and the Information Technology Management Reform Act of 1996 (ITMRA).

Agency Restructuring and Increasingly Limited Resources Prompted Review of Planning and Budgeting for Fixed Assets

OMB issued Bulletin 94-08, "Planning and Budgeting for the Acquisition of Fixed Assets"[2] in July 1994 as an initiative to improve the acquisition of fixed assets. The Bulletin emphasized the importance of effective fixed-asset acquisitions in an era of declining resources. Restructuring and downsizing pressures may tempt agencies to forego or neglect fixed-asset acquisitions; but, certain purchases, such as information technology, may be critical in enabling agencies to do more with less.

OMB also acknowledged that certain aspects of the budget process may exacerbate these tendencies. Recognizing many of the financing issues raised by our case studies, the Bulletin suggested that one-year funding may not allow sufficient time to complete the acquisition process, that one-time, large increases in appropriations requests for asset acquisitions

[1]The National Performance Review, under the leadership of the Vice President, is an executive branch management reform effort intended to make the government "work better and cost less." Among hundreds of NPR recommendations, generally intended to emphasize results and enhance managerial flexibility, were several dealing with managing fixed assets for the long term. See From Red Tape to Results: Creating a Government that Works Better and Costs Less: Improving Financial Management — Accompanying Report of the National Performance Review, Office of the Vice-President, September 1993.

[2]In this Bulletin, OMB defined fixed assets as buildings and equipment normally available from the commercial sector that support the delivery of federal services. Defense procurement, military construction, space programs, grants to state and local governments, and other infrastructure, such as dams and air traffic control, were excluded from the Bulletin's definition of fixed assets.

(lumpiness) may make capital spending relatively less attractive, and that combining spending for capital and operating expenses in one account may crowd out fixed-asset purchases. The Bulletin emphasized that agency planning and budgeting, as well as OMB's review process, must be improved.

As a first step toward making such improvements, the Bulletin required agencies to prepare and justify 5-year spending plans[3] for the acquisition of fixed assets and to conduct a review of funding mechanisms for fixed-asset purchases. The Bulletin stated that the 5-year plans would be used to develop the fiscal year 1996 President's budget and to discuss fixed-asset acquisitions in the budget. Agency review of funding mechanisms was intended to assess the adequacy of current funding mechanisms for fixed assets and to consider whether the full cost of fixed-asset acquisitions was being recognized in budget requests. Agencies were asked to consider expanding the use of multiyear appropriations, asset acquisition accounts (either revolving fund or appropriation accounts), and other mechanisms that might alleviate funding difficulties.

Completeness of Bulletin Responses Varied

OMB received data from most agencies expected to respond to the Bulletin, but the completeness of the responses varied. OMB officials expected 14 executive branch agencies would respond to the Bulletin on the basis of previously reported spending on fixed assets. Of these 14, 4 did not respond. Conversely, OMB received responses from three agencies not expected to respond. All of our case studies responded to the Bulletin, but the content of their submissions varied. The Corps' and USGS' responses were limited because neither agency had many fixed-asset purchases that met the Bulletin's reporting threshold. The Coast Guard and PBS used budget justifications and other previously prepared documents to support their 5-year plans and fulfill the Bulletin's request for a description of the planning process. Of the 13 agencies responding to the Bulletin,[4] only the Department of Veterans Affairs (VA) and the Coast Guard extensively discussed their evaluation of particular funding mechanisms for fixed asset purchases.

[3]Account-level detail of fixed-asset purchases was to be provided if $50 million or 50 percent or more of the account's budget authority or outlays was used to acquire fixed assets. Single acquisitions of $20 million or more also required account-level reporting.

[4]Agencies that responded to Bulletin 94-08 were: the Departments of Commerce, Defense, Education, Health and Human Services, the Interior, Justice, Transportation, the Treasury, and Veterans Affairs, the Environmental Protection Agency, the General Services Administration, the National Archives, and the National Science Foundation.

Two Agencies Discussed Funding Mechanisms for Fixed Assets

VA's response stated that "significant savings to the government could be realized if the type of acquisition was not determined prior to preparation of the budget." Noting that economic conditions can change in the minimum of 3 years between budget preparation and appropriation, VA explained that the acquisition method initially selected may not be economically viable or ideal at the time of purchase. To address this situation, VA managers discussed creating a single real property acquisition account where space need and budget authority need are identified in the budget prospectus and the particular acquisition strategy is determined upon execution of the purchase.

The Coast Guard discussed its ability to mitigate crowding out of fixed assets and its concern over the length of its fund availability. Funding both capital projects and the personnel needed to implement those projects as separate appropriation categories within a single account protects fixed-asset categories from competing with each other or non-capital expenditures. By forecasting and ranking long-term capital needs, the Coast Guard's capital investment plan allows the agency to control the frequency with which large spikes in appropriations are needed. Funding spikes are also managed by dividing acquisitions into stand-alone stages or components that can be budgeted for separately and over a period of years. However, the Coast Guard stated that the 1- and 3-year availability of capital personnel and shore funding, respectively, was inadequate to accommodate mission changes.[5]

Case Studies Found Bulletin's Requirements Easy to Meet With Previously Reported Data

Officials of case study organizations indicated that they made no significant changes in their capital budgeting practices as a result of the Bulletin. These officials also did not perceive any differences in the way OMB viewed their budget request as a result of the Bulletin responses. However, PBS officials felt the Bulletin was a constructive step in acknowledging their concerns over scoring inconsistencies and encouraging their efforts to focus on multiyear financial planning and the type of space being acquired. The Bulletin also prompted PBS to begin to focus on the outlay impact of their capital acquisitions.

Officials from our case studies generally felt the Bulletin response was easy to prepare because some fixed-asset data were being reported to OMB or the Congress in other formats. Officials from the Corps of Engineers, the Coast Guard, and USGS stated that the 5-year spending plans contained data that OMB or the Congress had previously seen in other reports.

[5]Coast Guard personnel funds appropriated in fiscal year 1997 are available for 2 years.

Therefore, these officials easily prepared Bulletin responses but thought the requirements were already being met through other submissions to OMB or Congress. For example, USGS had already provided detailed justification materials on its two purchases that met the Bulletin's reporting threshold under other OMB mandates.

Bulletin Responses Helped Identify Problems With Planning and Budgeting for Fixed Assets as Well as Mitigating Strategies

An OMB official who helped develop the Bulletin acknowledged that the comprehensiveness of Bulletin responses varied but felt that the responses were useful in identifying issues for further consideration. This official speculated that the content and completeness of agency submissions may have been affected by the short time frame agencies had to respond and by the fact that agencies were being asked to supply fixed-asset data for the first time. Concerned with balancing its need for information and the agencies' burden in supplying the information, OMB accommodated nonresponses through subsequent data requests by its program examiners. These requests and the formal Bulletin responses supported a narrative summary and 3-year table of "Fixed Asset Acquisitions" in the President's fiscal year 1996 budget.

The responses also supported the first-ever OMB Director's review of fixed assets. Director's reviews, at which the Director of OMB discusses and decides upon recommendations made by OMB examiners, are held on a limited number of topics each year. These discussions are significant because they can shape the content and presentation of the President's budget. The Director's review of fixed assets identified problems in planning and budgeting for fixed assets as well as mitigating strategies. The review found that some agencies lacked an integrated planning and budgeting process for fixed assets. For example, some agencies did not reflect operational changes that would occur from information technology acquisition in their long-range plans and budgets. Some agencies planned and budgeted for the acquisition of assets but did not fully plan and budget for related maintenance. The review also found that agencies were using a variety of account structures and strategies to justify fixed-asset acquisitions. Multiyear funding was widely used, especially for construction-related projects. Revolving funds were also widely used, although OMB did not receive any new requests for such funds. Some agencies tried to overcome difficulty in justifying large spending increases for capital by segregating all capital funding into one account to smooth annual changes in outlays and prevent the crowding-out of capital. Other agencies found that such accounts were not needed; spending increases for capital had been obtained when justified.

However, the primary focus of the OMB Director's review was up-front funding. Bulletin responses indicated that some capital spending was not fully funded. Specifically, capital projects of the Corps of Engineers, NASA, DOE, and the Bureau of Reclamation were incrementally funded. Some congressional staff acknowledged that such projects have traditionally been incrementally funded and indicated satisfaction with this practice. Until 1995, OMB explicitly permitted water resource projects to be incrementally funded.[6] However, OMB is concerned that inconsistent scoring of fixed assets may unfairly bias some acquisitions and that incremental funding may understate the cost of acquisitions.

OMB's Second-Year Effort Results in a Proposal to Expand the Use of Full Funding

In June 1995, OMB replaced Bulletin 94-08 with Bulletin 95-03. The two bulletins were nearly identical except that Bulletin 95-03 broadened the definition of fixed assets and added two reporting requirements. The definition of fixed assets was expanded to conform with the Federal Accounting Standards Advisory Board's (FASAB) recommended definition of general property, plant, and equipment.[7] In addition to assets meeting FASAB's definition, space exploration facilities and equipment and all DOE facilities were deemed fixed assets for purposes of the Bulletin. As a result, agencies were to consider nearly all construction, major rehabilitation, and purchases of fixed assets owned by the federal government in completing the Bulletin's reporting requirements.[8]

Bulletin 95-03 required agencies to provide information on the progress of acquisitions of $20 million or more and requested agencies to identify separable, stand-alone stages of fixed asset acquisitions. Information on acquisition progress was to be used to assess agencies' progress in meeting the cost and schedule goals of their acquisitions as required by the FASA. Information on stages of fixed-asset acquisitions was to be used for identifying those separable, stand-alone phases of an acquisition that should be fully funded up-front. Bulletin 95-03 suggested what constituted separable, stand-alone phases for buildings and information technology, but asked agencies to identify such stages for other assets.

[6]OMB Bulletin A-11 had exempted water resource projects from full funding requirements. This exemption was removed in 1995. However, the Rivers and Harbors Appropriation Act of 1922 permits incremental funding of Corps water resource projects and is still in effect.

[7]FASAB defined general property, plant, and equipment as items that are used (1) to produce goods or services or to support the mission of the entity and can be used for alternative purposes; (2) in business-type activities; or (3) by entities whose costs can be compared to other entities.

[8]The Bulletin explicitly excluded DOD weapons systems, the Postal Service, vacant land, and grants to state and local governments from the definition of fixed assets.

Only eight agencies formally responded to all aspects of Bulletin 95-03.[9] An OMB official attributed the low response partly to the lack of fiscal year 1996 appropriations for many agencies at the time submissions were due. However, the official noted that, as in 1994, OMB program examiners sought fixed-asset data from agencies when discussing overall budget requests. Therefore, OMB felt it had sufficient data to hold another Director's review of fixed assets. This second-year review focused primarily on the extent to which agencies were requesting full up-front funding for capital projects and how to encourage such requests. Although most agencies were requesting full funding for capital projects, the review identified some large capital projects that were not fully funded and prompted OMB officials to encourage full up-front funding when discussing budget requests with agencies.

OMB also determined that the discretionary spending caps on budget authority could accommodate full funding of some capital projects that would otherwise be incrementally funded. Full funding of these projects requires additional budget authority in the budget year but generally does not require additional outlays in the budget year. Because the sum of the President's discretionary spending proposals was less than the discretionary spending caps, OMB was able to request $1.4 billion in budget authority in the President's fiscal year 1997 budget to fully fund capital projects at the DOE and NASA.[10] In addition, OMB presented budget schedules showing the cost to fully fund ongoing and new capital projects at the Corps of Engineers and the Bureau of Reclamation. Although full funding was not requested for these agencies' capital projects, the schedules indicated the cost of fully funding ongoing and new projects for these agencies would be about $23 billion in fiscal year 1997, and OMB stated that efforts would be made to fully fund all new projects in the fiscal year 1998 budget.

[9]Agencies that formally responded to all aspects of Bulletin 95-03 were: the Departments of Health and Human Services, Justice, State, and Transportation, the Environmental Protection Agency, GSA, NASA, and the National Science Foundation.

[10]OMB noted that NASA would request full funding for more projects in fiscal year 1998 but did not provide cost estimates. Only a small portion of the $1.4 billion request was ultimately approved in FY97 appropriations actions.

OMB's Third-Year Effort Attempts to Link Fixed-Asset Planning and Budgeting With Performance Initiatives

OMB officials felt that responses to Bulletins 94-08 and 95-03 helped them move from information gathering to the development of guidance regarding the implementation of full funding. To guide agencies in submitting their fiscal year 1998 budgets and to raise the visibility of its fixed-asset effort among agencies, OMB replaced these bulletins with a new Part 3 to OMB Circular A-11.[11] Like the previous bulletins, the new Part 3 requires agencies to submit 5-year spending plans for major fixed-asset acquisitions and encourages agencies to consider the use of flexible funding mechanisms. In addition, it requires agencies to request full up-front funding for stand-alone stages of all ongoing and new fixed-asset acquisitions and outlines broad principles for planning and monitoring such acquisitions. Part 3 also attempts to streamline reporting requirements for three performance-related initiatives—FASA, ITMRA, and GPRA.

OMB officials believe that FASA, ITMRA, and GPRA share the objective of its fixed-asset reviews—to improve fixed asset planning and budgeting. FASA requires that executive agency heads (1) set cost, performance, and schedule goals for major acquisition programs, (2) monitor the programs to ensure they are achieving, on average, 90 percent of the established goals, and (3) take corrective actions, including termination, on programs that do not remain within the permitted tolerances. FASA also requires OMB to report to the Congress on agencies' progress in meeting these cost, schedule, and performance goals. ITMRA requires agency heads to establish goals for improving the efficiency and effectiveness of agency operations through effective use of information technology and to acquire information technology systems in successive acquisitions of interoperable increments. Under ITMRA, when the President submits the budget to the Congress, the OMB Director is to submit a report to the Congress on the net program performance benefits achieved as a result of agencies' major information systems projects and on how the benefits of such projects relate to agencies' goals. Under GPRA, agencies must develop, no later than by the end of fiscal year 1997, strategic plans that cover a period of at least 5 years and include the agency's mission statement; identify the agency's long-term strategic goals; and describe how the agency intends to achieve those goals through its activities and through its human, capital, information, and other resources. GPRA also requires each agency to submit to OMB, beginning for fiscal year 1999, an annual performance plan.[12] In essence, the annual performance plan is to contain the annual performance goals the agency will use to gauge its progress

[11]Circular A-11 instructs agencies on submitting their budget requests.

[12]The first annual performance plans are to be submitted in the fall of 1997.

toward accomplishing its strategic goals and identify the performance measures the agency will use to assess its progress. In issuing Part 3, OMB sought to centralize its information requests to fulfill FASA and ITMRA reporting requirements and to ensure that fixed-asset acquisition plans support the plans and goals developed for these initiatives and GPRA.

Because the planning requirements of GPRA are not yet effective and have not yet been fully implemented, the new Part 3 of Circular A-11 requires agencies to describe how ongoing or proposed capital acquisitions relate to the agency's mission and goals being defined under GPRA. It outlines broad principles for linking long-range planning and budgeting for fixed assets to the strategic and annual performance plans agencies develop for GPRA. For example, OMB advises agencies to develop long-range fixed-asset plans by ranking long-term goals and considering the most efficient and effective means of achieving those goals within budgetary constraints. Part 3 also urges agencies to monitor whether fixed-asset acquisitions are helping achieve their goals.

Observations and Conclusions

While capital spending is important to efficient long-term government operations, a goal of the budget process should be to assist the Congress in allocating resources efficiently by ensuring that various spending options can be compared impartially—not necessarily to increase capital spending. The requirement of full up-front funding is an essential tool in helping the Congress make trade-offs among various spending alternatives. However, in an environment of constrained budgetary resources, agencies need tools that can help facilitate these trade-offs and that enable them to accommodate up-front funding. Furthermore, to successfully implement GPRA's requirement for program performance measures, managers will also need to know the full costs of their programs—including capital usage.

Some have recommended that the government adopt a full-scale capital budget, but this raises major budget control issues and may not be necessary to address agency-identified impediments to capital spending. Rather, our case studies demonstrate that more modest tools, such as revolving funds, investment components, and budgeting for stand-alone stages, can help accommodate up-front funding without raising the congressional or fiscal control issues of a separate capital budget. Though each of the strategies has limitations, when accompanied by good financial management and appropriate congressional oversight, they can be useful in facilitating effective capital acquisition within the current unified budget context. In addition, one strategy, using a revolving fund, can be effective in helping to make managers aware of the full cost of their programs.

The Budget Process Should Encourage Prudent Capital Decisions

The budget process must balance several sometimes conflicting goals to facilitate effective trade-offs among various spending options. First, it is important that the budget process reveal the entire cost of operating particular programs—including the cost of capital assets used by the program. Knowledge of full program costs is especially significant as agencies and the Congress begin to implement GPRA's requirements for performance measurement and budgeting. For example, if both capital and operating costs are not attributed to programs over time, programs may appear deceptively inexpensive. In addition, the cost of replacing assets is borne entirely by future agency managers and Congresses that may not have been responsible for asset consumption. Second, the budget process ought to enable lawmakers to compare the full, long-term costs of various spending alternatives. Thus, long-term commitments, such as purchases or lease-purchases, are scored up-front in the budget. Third, the Congress needs to be assured that agencies are spending funds as directed by law

and be able to control total federal spending. Fourth, agencies need the flexibility and incentives to make economic decisions regarding capital acquisition and usage.

Full up-front funding is one of the tools that has been important to facilitating fiscal control and comparisons of the long-term costs of spending alternatives. An essential part of prudent capital planning must be an adherence to full up-front funding. When full up-front funding is not practiced, the Congress risks committing the government to capital acquisitions without determining whether the project is affordable over the long-term. Incremental funding also compels future Congresses to fund a project in order to prevent wasting resources previously appropriated. As budgetary constraints continue, incremental funding may lock the Congress into future spending patterns and reduce flexibility to respond to new needs. In the budget process, fully funded projects may be disadvantaged in competition with incrementally funded projects—even when the fully funded projects actually cost less in the long-run.

However, full up-front funding can impede agencies' ability to economically acquire capital in an environment of resource constraints. Full up-front funding of relatively expensive capital acquisitions can consume a large share of an agency's annual budget, thereby forcing today's decision-makers to pay all at once for projects with long-lived benefits. While various capital budgeting proposals have been advanced to address this, the proposals themselves have raised significant concern because of their potential diminution of fiscal accountability and control. Consequently, agencies need financing tools that can provide the fiscal control of up-front funding and can enable them to make prudent capital decisions within the current unified budget frame work.

Agencies and the Congress Must Work Together to Find Tools That Encourage Prudent Capital Decisions

Our case studies provide some examples of tools that can encourage effective capital decisions. Several use revolving funds to help accumulate resources for capital replacement and to help incorporate capital costs into program budgets. This will become of increasing importance as implementation of GPRA will require managers to know the full annual cost of their programs and to evaluate the performance of programs based on the full cost. Because revolving funds charge users for the cost of capital, managers have an incentive to regularly assess their need for and use of assets. By providing managers with a predictable stream of funding, revolving funds also encourage long-range capital planning. Our work indicates that revolving funds are most effective when (1) agencies have a

sound record of financial management, (2) costs can be tracked to users, (3) replacement cost is recovered, (4) appropriations are available to fund significant or immediate expansions of the fund's asset base, (5) proceeds from the disposal of fund assets are retained by the fund if the fund is expected to provide a constant level of service, and (6) used to finance small-scale, ongoing capital needs. Our case studies also indicate that revolving funds can provide varying degrees of congressional control. IFMS has few restrictions on the type of vehicles it can purchase; in contrast, the Congress approves every large purchase by the Corps' and PBS' revolving funds. Oversight by the Congress is important to ensuring that agency acquisitions are well-planned and justified and that the agency's overall level of capital spending is appropriate given other competing capital and operating needs across the government.

An investment component within a working capital fund generates many of the same benefits as revolving funds. In addition, an investment component may encourage agency managers to fund their voluntary contributions by making tradeoffs between capital and operational spending. Although the investment component is a recent development and used by only one of our case studies, it seems especially helpful for agencies that would otherwise fund capital with annually expiring funds. USGS' investment component operates with few restrictions apart from prohibitions against building construction and using funds within 2 years of their placement in the investment component. However, expanding the use of an investment component to other agencies may require other limitations. For example, if several agencies obtain investment components and each decides to make large purchases in the same year, total outlays could rise sharply and cause a spike in the deficit. Therefore, OMB would need to manage all investment components to ensure total investment component outlays do not cause such spikes. The Congress must also be aware that an investment component may encourage agencies to build unobligated balances and that agencies would need to be held accountable to their investment plans.

In addition to using revolving funds or an investment component, some case studies budget for stand-alone stages of capital acquisitions and use reprogramming authority. Budgeting for stand-alone stages makes capital acquisition affordable by limiting the budget authority needed at one time. It may also increase opportunities for oversight and permit adjustment of capital funding levels when other needs emerge. This tool can be used when parts of an acquisition can be useful without the whole being completed. If used as intended, reprogramming authority also helps

agencies respond when changes in funding or mission leave inadequate funding to complete a capital acquisition or create new capital needs. Congressional control is maintained by limiting the amount of such authority.

Multiyear and no-year funding help agencies accommodate capital's longer acquisition cycle. All of our case studies had the opportunity to fund capital through multiyear appropriations or a revolving fund. However, agencies and the Congress must work together to find a period of fund availability that is long enough to complete the agency's projects and short enough to discourage delays. The Congress can maintain control over no- and multiyear funding through individual agency reporting and FASA requirements.

The strategies used by our case studies may not be all inclusive of those available to all federal agencies but are indicative of the kinds of tools agencies find useful. Some of these mechanisms, such as revolving funds and investment components, share to varying degrees common characteristics that help agencies make effective capital acquisitions. For example,

- They enable agencies to accumulate resources without fiscal year limitations in order to finance capital needs.
- They promote full costing of programs and activities by including costs related to capital usage in operating budgets.
- They provide a degree of predictability to funding levels that aids in long-range planning.

In addition to considering the provision of tools with these characteristics, the Congress and OMB should continue to encourage agencies to improve capital planning. Three recent legislative initiatives—GPRA, FASA, and ITMRA—seek to improve agency planning for programs and capital acquisitions. OMB's bulletins and guidance on fixed-asset planning and budgeting have been valuable contributions toward promoting agency capital planning. Also, given the governmentwide trend in downsizing, agencies may need to consider alternatives to ownership of capital assets. For example, agencies may purchase the use of assets through service contracts with private-sector organizations or other agencies. In other instances, agencies may need to explore creative ways of leveraging resources with the private sector, such as limited partnerships and loan guarantees, in order to meet their specific asset requirements.

While agencies are concerned that the budget process facilitate capital acquisitions, it should be understood that agencies must ensure that capital projects are properly selected and well-managed. Flexible financing mechanisms and up-front funding can help to improve the chances that agencies can fully fund capital projects and will select financing methods that are most economical for the government. However, to ensure that funds are well used, it is imperative that agencies have a sound process for selecting which capital projects to fund and to manage those projects well. We have shown that many information technology projects undertaken by agencies have been poorly managed and wasted federal resources.[1] Agencies could benefit from viewing capital projects—especially information technology—as investments that require explicit decision criteria and performance measures that assess risks, costs, and benefits.[2] Long-range risks, costs, and benefits of various capital spending alternatives should be presented in budget justifications to the Congress. None of the budget tools discussed can be a substitute for good cost-benefit analysis and well-managed project implementation.

Recommendations to the Office of Management and Budget

GAO recommends that the Director of the Office of Management and Budget continue OMB's top-level focus on fixed-asset acquisitions to include working with agencies and the Congress to promote flexible budgetary mechanisms that help agencies accommodate the consistent application of up-front funding requirements while maintaining opportunities for appropriate congressional oversight and control.

As OMB continues to integrate GPRA requirements into the budget process, GAO recommends that the Director of the Office of Management and Budget, ensure that agencies' capital plans flow from and are based upon their strategic and annual performance plans. In addition, OMB should continue its efforts to ensure that cost, schedule, and performance goals are monitored as required by FASA.

Matter for Congressional Consideration

Although requiring that budget authority for the full cost of acquisitions be provided before an acquisition is made allows the Congress to control capital spending at the time a commitment is made, it also presents challenges. Because the entire cost for these relatively expensive

[1]Managing for Results: Steps for Strengthening Federal Management (GAO/T-GGD/AIMD-95-158, May 9, 1995).

[2]Executive Guide: Improving Mission Performance Through Strategic Information Management and Technology (GAO/AIMD-94-115, May 1994).

acquisitions must be absorbed in the annual budget of an agency or program, fixed assets may seem prohibitively expensive despite their long-term benefits.

This report describes some strategies that a number of agencies have used to manage this dilemma. The Congress should consider enabling agencies to use more flexible budgeting mechanisms that accommodate up-front funding over the longer term while providing appropriate oversight and control. For agencies having proven financial management and capital planning capabilities and relatively small and ongoing capital needs, these techniques could include revolving funds and investment components. Such techniques enable agencies to accumulate resources over a period of years in order to finance certain capital needs, promote full costing of programs and activities by including costs related to capital usage in program budgets, and provide a degree of funding predictability to aid in long-range planning. As GPRA moves toward full implementation, these and other tools may take on increasing importance in helping managers and the Congress to identify program costs and to more efficiently manage capital assets.

Agency Comments and Our Evaluation

Officials from our case studies and OMB agreed with this report's conclusions and recommendations. They also provided technical corrections which have been incorporated in this report where appropriate. In commenting on a draft of this report, OMB and GSA officials raised issues which required clarification and elaboration in some sections of the report.

OMB officials agreed with the report's support for up-front funding of capital assets but expressed concern that the use of intragovernmental revolving funds to fund capital acquisitions in some circumstances would undermine the up-front funding principle and reduce budgetary control. OMB proposed that a revolving fund could be used to fund relatively large, sporadic, or heterogeneous purchases if the revolving fund borrowed from Treasury and charged users to recover the principal and interest payments. This would facilitate congressional and executive review of such purchases while allocating capital costs to users. However, unless a relatively constant amount of capital spending is undertaken by the fund each year, such a revolving fund would cause a spike in budget authority each time an asset is purchased. Therefore, to clarify that revolving funds are not always appropriate for making capital acquisitions, references

were added throughout the report to indicate their appropriateness for relatively small and ongoing capital needs.

GSA officials expressed a desire for some discussion of proposed changes in scoring operating leases. Reference to previous GAO testimony on this matter was added to chapter 3. GSA officials also expressed their belief that congressional control could be maintained if the FBF retained proceeds from the disposal of PBS properties. The officials suggested that, because all funds deposited in the FBF must now be appropriated before use, the Congress would have an opportunity to determine how disposal proceeds should be used. This report provides observations on circumstances which affect whether agencies should retain proceeds, such as the need to provide a constant level of services. It was not intended to address whether such circumstances exist in any specific agency. Each agency's situation would need to be assessed individually to select the appropriate financing mechanism and to determine how to handle disposal proceeds. Therefore, the report was not altered to address this comment.

Comparison of Case Studies and Other Organizations Contacted

Table I.1 lists selected characteristics of our case studies as well as four other federal organizations with which we conducted limited interviews.[1] The table shows the range of capital spending and capital financing mechanisms used by these organizations.

The column immediately to the right of the organization's name gives an indication of the magnitude of capital spending at each of these organizations but does not permit reliable comparisons. As further discussed in chapter 1, data limitations prevent a common measurement of capital spending for these organizations that is consistent with our definition of capital. Therefore, a measurement basis was selected for each organization that yields an approximation of capital spending. Capital spending for the Coast Guard, the Corps of Engineers, FDA, the Forest Service, and NOAA represents the outlays those organizations made directly for construction and rehabilitation, major equipment, and the purchase or sale of land and structures in fiscal year 1995.[2] IFMS' and PBS' capital spending is derived from these organizations' categorization of their fiscal year 1995 obligations as either capital investment or operating spending.[3] Capital spending at USGS and ITS represents the obligations made for the items of expense designated "equipment" and "land and structures" in fiscal year 1995.[4]

The table also provides examples of the types of fixed assets acquired by these organizations and lists the accounts used to fund most fixed-asset acquisitions.[5] The table indicates whether any of these accounts are revolving funds and shows the appropriations subcommittee charged with providing funds for fixed-asset acquisitions. The final two columns show the length of time for which fixed-asset funding is available and the amount of funds rescinded from accounts used to fund fixed assets during fiscal year 1995. A rescission may reflect reductions of funds made available to the account in fiscal year 1995 or in previous years. We could

[1]See Objectives, Scope, and Methodology in chapter 1 for more detail.

[2]Capital spending for these organizations is the sum of outlays reported in the OMB MAX system for character classes 1312, 1314, 1322, 1324, and 1340.

[3]Capital spending for these organizations corresponds to the "Capital Investment" line item in each organization's program and financing schedule as reported in the appendix to Budget of the United States Government, Fiscal Year 1997.

[4]Capital spending for these organizations is the sum of obligations for object classes 31.0 and 32.0 and includes amounts listed under the line item "Reimbursables" within the object class schedules reported for these organizations' accounts in the appendix to Budget of the United States Government, Fiscal Year 1997.

[5]The fixed assets and accounts listed are not all inclusive of the spending in the table's second column due to the data limitations described in chapter 1.

not readily determine whether a rescission reduced capital spending when the affected account made capital and operating expenditures.

The table indicates that these organizations vary in the magnitude of and financing mechanisms used to fund capital spending. USGS spends relatively little on capital assets (about 6 percent of total obligations) but also has a much smaller total budget than the other organizations. Conversely, about 40 percent of the Corps' $3.9 billion of outlays is spent on capital acquisitions. Two-thirds of the organizations in this table have a revolving fund that finances at least some of their capital spending. Three organizations—the Corps, USGS, and the Forest Service—finance their fixed-asset acquisitions through a combination of appropriations accounts and revolving funds. The Corps and the Forest Service fund large-scale construction from their appropriations accounts and generally use revolving funds to finance smaller acquisitions, such as equipment and small-scale construction. USGS funds both capital and operating expenses from the same appropriations account. Conversely, a capital-intensive organization, such as the Coast Guard, has an appropriations account dedicated to financing capital. Despite differences in the accounts used to finance capital, all organizations had access to funds with multi- or no-year availability for their capital acquisitions.

The table also indicates that construction funds were rescinded from nearly every organization with such an appropriation. Funding was generally not rescinded from revolving funds. This dichotomy occurs because long-term construction projects result in accumulations of unobligated balances, which are the object of rescissions. In contrast, the revolving funds of these organizations tend to obligate funds more quickly because their purchases are typically smaller and have shorter acquisition cycles.

Table I.1: Comparison of Case Studies and Other Organizations Contacted

Organization	Fiscal year 1995 capital spending (in millions)	Examples of fixed assets acquired
Coast Guard	$290[b]	Vessels, aircraft, shore facilities, information technology
Corps of Engineers	$1,542[c]	Equipment, facilities, information systems
USGS	$56[f]	Information systems, telecommunications, and scientific equipment
GSA - IFMS	$502[h]	Motor vehicles
GSA - ITS	$37[f]	Telephone switches
GSA - PBS	$1,631[i]	Office buildings, courthouses, special purpose buildings
FDA	$17[b]	Equipment, facilities
Forest Service	$6[k]	Recreation facilities, offices, housing, laboratories, tree nurseries, aircraft
NOAA	$83[l]	Research laboratories, weather data gathering equipment

Account(s) used to fund fixed assets[a]	Have a revolving fund for fixed asset acquisition?	Appropriations subcommittee	Funding availability for fixed-asset purchases	Rescission in fiscal year 1995
Acquisitions, construction, and improvements	No	Transportation	Multiyear	$36.0 million
Revolving fund[d]	Yes; for equipment and facilities	Energy and Water	No-year[e]	$60.0 million from Construction
Surveys, investigations, and research; Working capital fund	Yes	Interior	No-year[g]	$0
General supply fund	Yes	Treasury	No-year	$0
Information technology fund	Yes	Treasury	No-year	$0
Federal buildings fund	Yes	Treasury	No-year	$631.0 million
Buildings and facilities[j]	No	Agriculture	No-year	$0
Construction; Working capital fund	Yes; for equipment, tree nurseries, and aircraft	Interior	No-year	$6.0 million from Construction
Construction; Operations, research and facilities; Fleet modernization, shipbuilding, and conversion	No	Commerce	No-year	$15.0 million from Construction; $24.2 million from Operations

[a]Account titles are those given in the appendix to Budget of the United States Government, Fiscal Year 1997 unless otherwise noted.

[b]Capital spending is outlays for character classes 1312, 1314, 1322, 1324, and 1340.

[c]Capital spending is outlays for character classes 1312, 1314, 1322, 1324, and 1340. This figure includes spending for dams, flood control, and other items that do not meet our definition of fixed assets. Obligations for the Corps' plant replacement and improvement program were $91 million in fiscal year 1995.

[d]Although Corps fixed assets used on multiple civil works projects are acquired through a revolving fund, other fixed assets are acquired through the Corps' appropriations accounts, including the Construction, General and Flood Control, and Mississippi River and Tributaries accounts.

[e]Managed by Corps headquarters as single-year availability.

[f]Capital spending is the sum of obligations for object class 31.0, "equipment," and object class 32.0, "land and structures." This figure includes amounts listed under "Reimbursables" in the USGS object class schedules presented in the appendix to Budget of the United States Government, Fiscal Year 1997.

[g]The working capital fund does not have any restrictions on availability; funds of the Surveys, Investigations, and Research account are available for 1 year.

[h]Capital spending is obligations for "Fleet management: purchase of equipment" from the General Supply Fund's program and financing schedule in the appendix to Budget of the United States Government, Fiscal Year 1997.

[i]Capital spending is obligations for "Capital investment" from the Federal Building Fund's program and financing schedule in the appendix to Budget of the United States Government, Fiscal Year 1997.

[j]FDA's Buildings and facilities account is consolidated with its Salaries and expenses and Rental payments accounts for presentation in the Budget of the United States Government, Fiscal Year 1997.

[k]Estimated capital spending is outlays for character classes 1312, 1314, 1322, 1324, and 1340. Forest Service spending on "other physical assets" (character class 1352) was $2.2 billion.

[l]Capital spending is outlays for character classes 1312, 1314, 1322, 1324, and 1340 in the "Construction" and "Fleet modernization, shipbuilding, and conversion" accounts. Other accounts did not record outlays for these character classes. In comparison, NOAA's obligations in object classes 31 and 32 total $189 million.

The Coast Guard

The Coast Guard is an agency of the Department of Transportation that conducts search and rescue, aids to navigation, marine safety and environmental protection, icebreaking, enforcement of laws and treaties, and defense-related programs. It is unique among our case studies because most of its capital spending is made from a single appropriations account dedicated to capital called Acquisitions, Construction, and Improvements (AC&I).

Fixed Assets Acquired

The Coast Guard acquires a variety of fixed assets including vessels, aircraft, information technology, and shore facilities through its AC&I account. The AC&I account also funds 670 Coast Guard full-time equivalents (FTE) who support capital acquisition and construction. The Coast Guard had a total of about 33,000 FTEs in fiscal year 1995.

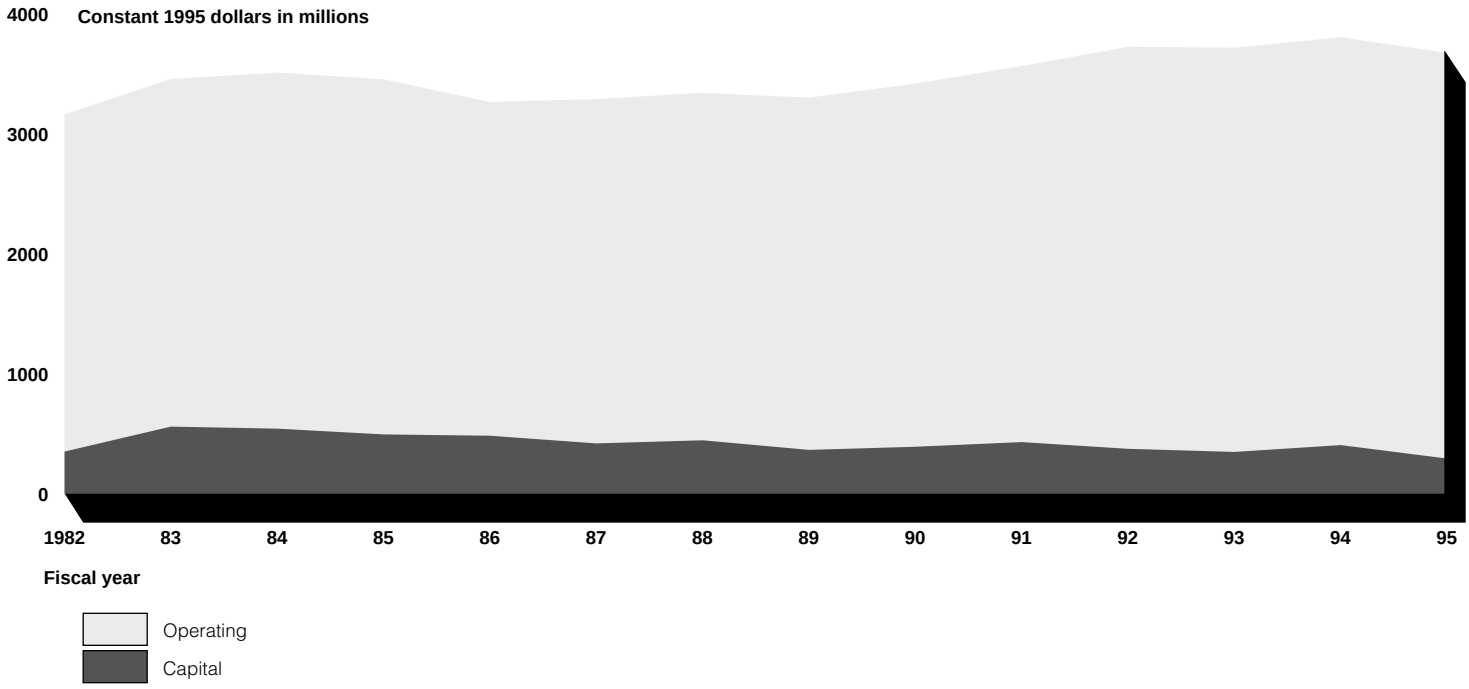
Capital Spending Trends

The Coast Guard experienced an increase in its operating outlays and a decrease in its capital outlays in real dollars between fiscal years 1982 and 1995.[1] (See figure II.1.) Operating outlays were $3.4 billion in fiscal year 1995, about 1.2 times the real 1982 level. Capital outlays generally fell throughout this period, reaching a high of $556 million in 1983 and a low of $290 million in fiscal year 1995. Figures II.1 and II.2 may not include spending by DOD for capital assets used by the Coast Guard. Such spending by DOD was relatively common during the 1980s but has not been significant since 1991.[2]

[1]Capital outlays as referred to in figure II.1 and figure II.2 are not necessarily equivalent to our definition of capital. Capital outlays are the sum of outlays reported in OMB character classes 1312, 1314, 1322, 1324, and 1340 for the Coast Guard. (See chapter 1 for more information on character classes and the limitations of this data.) Coast Guard operating outlays were derived by subtracting capital outlays from total net outlays.

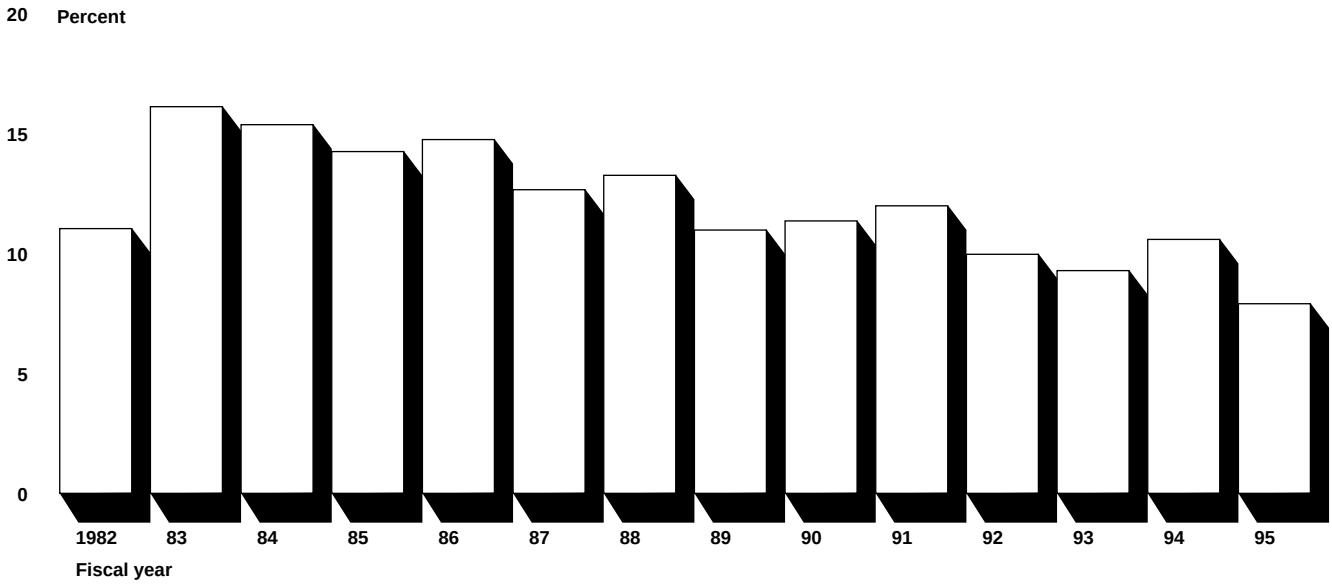
[2]In most years between 1982 and 1990, appropriations were made to DOD for Coast Guard capital acquisitions. The amount of these appropriations varied, ranging from $5 million to about $400 million annually. However, due to data limitations, we were unable to determine how much of these appropriations is reflected in the character class data. Relatively small appropriations were also made to DOD for Coast Guard operational spending, and these, too, may not be fully reflected in the data above.

Figure II.1: Coast Guard Capital and Operating Outlays for Fiscal Years 1982 Through 1995



As shown in figure II.2, capital outlays as a percent of the Coast Guard's total outlays decreased between fiscal years 1983 and 1995. After reaching a high of 16 percent in 1983, capital as a portion of total outlays gradually fell to a 14-year low of 8 percent in fiscal year 1995.

Figure II.2: Coast Guard Capital Outlays as a Percent of Total Outlays for Fiscal Years 1982 Through 1995



Sources and Uses of Funding

An appropriation to the AC&I account currently funds the majority of the Coast Guard's fixed-asset acquisitions. The appropriation has five categories: vessels, aircraft, other equipment, shore facilities, and personnel.[3] Personnel funds have 2-year availability, aircraft, other equipment, and shore facilities funds have 3-year availability, and vessels funds have 5-year availability. DOD was a significant source of funds for the Coast Guard's defense-related fixed assets. For example, DOD provided $339 million for a Coast Guard icebreaker in fiscal year 1990. Although AC&I funding has not been supplemented by DOD funds for the last 4 fiscal years, DOD funds nearly doubled the AC&I budget in fiscal years 1982, 1984, 1986, 1987, and 1990.

Capital Planning and Budgeting Process

The Coast Guard uses its Strategic Planning, Long-Range Planning, Programming, Budgeting, Execution, and Evaluation System to forecast capital needs. Based on the long-range strategic plans and program objectives developed by this system, the Coast Guard annually predicts fixed-asset requirements for the next 15 years and documents them in its Capital Investment Plan (CIP). The CIP helps the Coast Guard anticipate and

[3]The personnel category funds Coast Guard employees who support capital acquisition and construction.

plan for years with spikes in fixed-asset needs and smooth out these resource demands over a period of years. The CIP is also used to determine which projects to request funding for within the annual guidance provided by OMB and the Office of the Secretary of the Department of Transportation.

Consistent with the principle of full funding, the Coast Guard budgets for either an entire capital project or useable stand-alone portions of a capital project. For construction of shore facilities, the Coast Guard generally requests funding to cover all projected costs of the project. In contrast, appropriations requests for vessels are limited to funding needed to complete a useable portion of the total project. For example, if the total project is to procure 30 vessels, the Coast Guard may write a base-year contract for a lead ship and spare parts that includes options to purchase the remaining vessels over a period of years. Such a contract limits the Coast Guard's commitment to the base-year acquisition; the Coast Guard need not exercise any of the options. In the first year of the project, the Coast Guard would request funds for the base-year contract. In subsequent years, the Coast Guard would decide whether to request funds to exercise a contract option.

Once appropriations are received, the Coast Guard cannot reprogram budget authority between the five AC&I categories or transfer budget authority between any other Coast Guard account and AC&I. The Coast Guard can reprogram up to the lesser of $1 million or 15 percent of the total amount appropriated for a project within each AC&I category and can move AC&I personnel between projects.

Response to OMB Bulletin 94-08

Coast Guard officials submitted the required 5-year plan, their CIP, and a discussion of the agency's planning and budgeting process in response to Bulletin 94-08. Coast Guard officials stated that the bulletin's requirements were easily met by consolidating information already contained in the CIP with current estimates for the budget year. Coast Guard officials stated that much of the information contained in the bulletin response was already available to the Congress and the administration in other required reports.

U.S. Army Corps of Engineers

The Army Corps of Engineers is an agency within the Department of Defense responsible for constructing and maintaining flood control, navigation, and other water resource projects. The Corps' construction projects are funded through appropriations and the contributions of local partners.[1] Fixed assets that are employed on multiple construction projects are funded through a revolving fund that charges individual projects for use of these assets. Fixed asset purchases are reviewed and approved annually by the Corps' appropriations subcommittees.

Fixed Assets Acquired

The Corps acquires a variety of fixed assets, including boats, buildings, bulldozers, communications equipment, computer hardware and software, and dredges. Corps officials said the revolving fund has spent between $80 and $100 million annually over the last 10 years to acquire such assets for use on multiple projects. The book value of revolving fund assets was about $800 million at the end of fiscal year 1994.

However, only a portion of the Corps' total capital spending as reported to OMB and shown in figures III.1 and III.2 is for fixed assets as defined in this report. The remaining capital outlays include spending for dams, flood control, and other items that are financed through appropriations and that do not meet our definition of fixed assets.

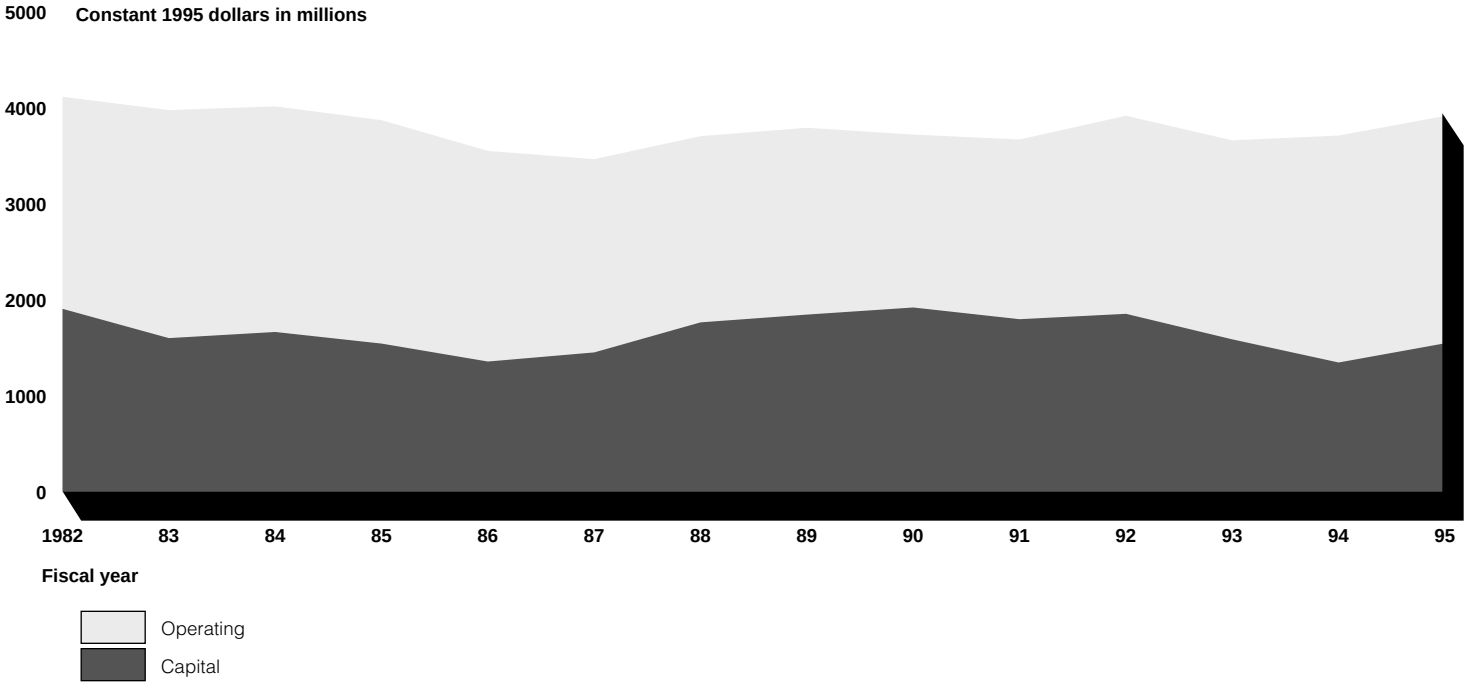
Capital Spending Trends

Figure III.1 illustrates that between fiscal years 1982 and 1995, the Corps' total real outlays fluctuated between a low of $3.5 billion in 1987 and a high of $4.1 billion in 1982.[2] The Corps' capital outlays varied between a low of $1.3 billion in fiscal year 1994 and a high of $1.9 billion in 1982 and 1990.

[1]These partners are generally local or state governments or other public entities, such as flood control districts or port authorities.

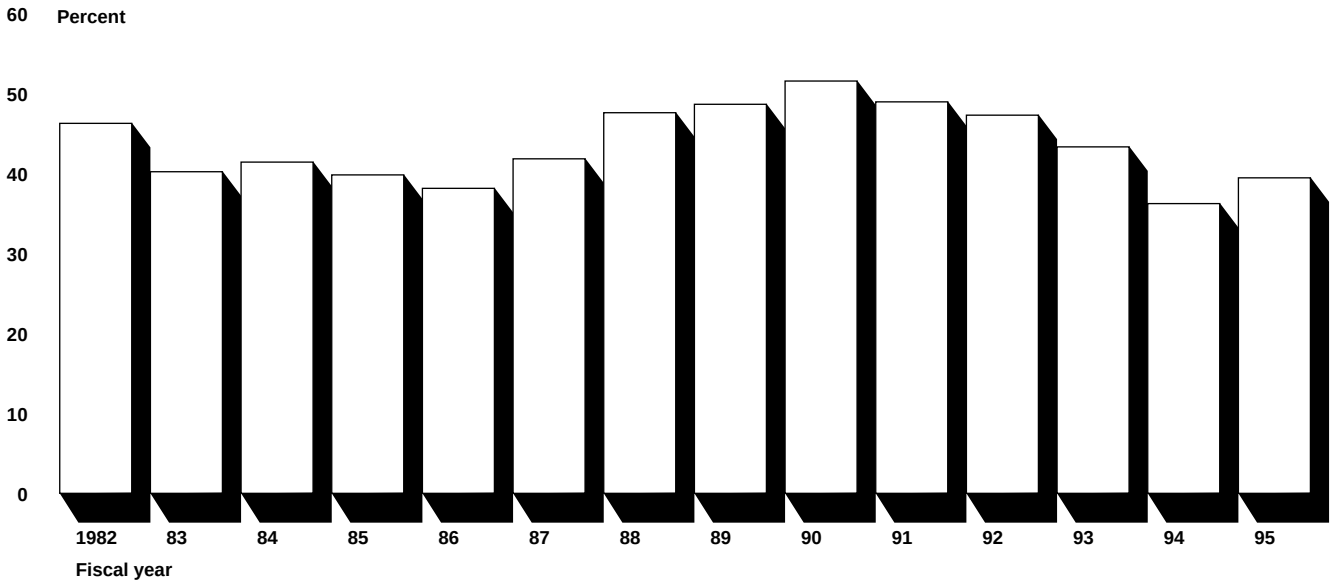
[2]Capital outlays as referred to in figure III.1 and figure III.2 are not necessarily equivalent to our definition of capital. Capital outlays are the sum of data outlays reported in OMB character classes 1312, 1314, 1322, 1324, and 1340 for the Corps. (See chapter 1 for more information on character classes and the limitations of this data.) Corps operating outlays were derived by subtracting capital outlays from total net outlays.

Figure III.1: Corps Capital and Operating Outlays for Fiscal Years 1982 Through 1995



As shown in Figure III.2, capital outlays constituted relatively less of total Corps outlays during fiscal years 1994 and 1995 than in most of the previous 12 years. As recently as 1990, 52 percent of Corps' outlays were spent on capital; in 1995, 39 percent of outlays were spent on capital.

Figure III.2: Corps Capital Outlays as a Percent of Total Outlays for Fiscal Years 1982 Through 1995



Sources and Uses of Funding

The Corps developed its Plant Replacement and Improvement Program (PRIP) to guide the acquisition and replacement of Corps-owned fixed assets that are shared by multiple civil works projects. PRIP generally relies on user charges from individual water resource projects or other federal agencies to finance the maintenance and replacement of these assets. User charges are set to recover operating costs, such as labor and fuel, and fixed costs, such as depreciation, plant increment,[3] and insurance. Charges are reviewed every quarter and adjusted, if necessary, to ensure equitable cost recovery.

Although PRIP charges are set and collected to replace or purchase a particular asset, collections for each asset are not segregated and saved until that particular asset is retired. Corps managers use each year's resources to fund the particular asset needs of that year. All assets are not replaced one-for-one. As technologies and missions evolve over time, Corps managers adjust PRIP purchases to match the new asset needs that arise.

[3]Plant increment represents the higher future costs of replacement due to inflation.

Proceeds from the disposal of PRIP assets can also be used to finance replacement. However, disposal typically does not produce significant revenue because assets are often donated to other Corps or Army units when they are no longer useful. The Corps has discretion to dispose of most assets, but disposal of dredges requires congressional approval.

Significant and immediate expansions of PRIP's asset base are generally financed with appropriations. According to a Corps document, thirteen appropriations have been made to expand the capital base during the fund's 40-year history. The Corps last received such an appropriation in fiscal year 1990 for the acquisition of a mainframe computer system.

Capital Planning and Budgeting Process

Planning and budgeting for PRIP purchases is achieved through preparation of a 5-year plan, a major item new start[4] (MINS) authorization request, and a PRIP funding request.

A 5-year plan is prepared by each of the Corps districts and lists all fixed assets a district would like to acquire through PRIP. At this juncture, districts are not given a budget target. Requested assets are classified into the following PRIP categories: land, structures, aircraft, dredges, floating plant, mobile land plant, fixed-land plant, computers, software, and tools and equipment. The PRIP manager at headquarters receives but does not scrutinize each district's 5-year plan, nor are the plans forwarded to OMB or the Congress. The 5-year plans help the PRIP manager know what districts need now and in the future and facilitate projections for the President's budget. The districts revise their 5-year plans every 6 months to reflect funding decisions or changes in needs.

In April, 2 years before the beginning of the budget year, districts request through their respective divisions a MINS authorization that is supposed to correspond to the first year of the 5-year plan. Each district's authorization request is supported by formal justifications and economic analyses. Districts are not given an authorization target; their requests are unconstrained.[5] Divisions review, sort, and consolidate authorization requests from the districts. Each of the Corps' divisions submits a consolidated request to headquarters. Headquarters assesses whether

[4]A major item new start is any single PRIP purchase over $700,000.

[5]Units are prohibited from purchasing some items by Corps management and the Congress. For example, the Corps currently has a moratorium on the purchase of optical disk imaging and video teleconferencing equipment until standard, Corps-wide specifications are developed. The Congress has prohibited the Corps from owning more than four aircraft and purchasing additional dredges.

districts will have sufficient future resources to reimburse the revolving fund for replacement of the requested asset and considers whether civil works projects can share assets. Headquarters ranks asset requests across the divisions and determines which assets can be purchased based on projections of PRIP income. If an asset need represents a large or immediate expansion of the asset base rather than replacement of an existing asset, headquarters will determine whether appropriations should be requested to supplement PRIP income. After these funding decisions are made, a Corps-wide MINS authorization request is submitted to OMB. After OMB approval and incorporation in the President's Budget, the MINS authorization request is provided to appropriations subcommittees in the form of "justification sheets." These sheets contain a narrative description of each MINS and show the total and annual amounts provided, requested, and needed for each MINS.[6] The total amount of the PRIP program, including minor items, is also presented to the Corps' appropriations subcommittees. By approving the entire PRIP program, these subcommittees set an annual target on PRIP expenditures. The Corps' appropriations subcommittee in the House of Representatives also receives the revolving fund's financial statements during the budget process.

Once the PRIP budget has been approved, any reprogramming that exceeds planned spending in the PRIP categories by more than 10 percent must be approved by the Corps' appropriations subcommittees. The Corps cannot transfer money to or from the fund without congressional approval.

Although the Congress does not restrict the period of availability of PRIP funds, Corps headquarters manages PRIP as though availability was single-year. If districts do not obligate funds for authorized purchases within a year, funds revert to Corps headquarters. Corps officials feel that managing PRIP as if funds were available for 1 year allows management to decide how resources can be best used and is consistent with its subcommittees annual approval of PRIP spending.

Response to OMB Bulletin 94-08

Corps officials submitted the required 5-year plan and a description of the agency's planning and budgeting process in response to Bulletin 94-08. Because water resource projects were excluded from the Bulletin's definition of fixed assets, the submission pertained only to PRIP purchases that met the reporting threshold.[7]

[6]Construction of some of these assets is funded on an incremental basis.

[7]Bulletin 95-03 expanded the definition of fixed assets to include the Corps' water resource projects.

Corps officials were easily able to fulfill the Bulletin's reporting requirements because the Congress and OMB already received much of the data required by the Bulletin, although in a less organized or comprehensive format. Corps officials felt that OMB examiners were already familiar with the agency's needs and budgeting practices and did not gain new insights from the submission.

The Interagency Fleet Management System

The Interagency Fleet Management System (IFMS) is a component of GSA's Federal Supply Service (FSS). FSS provides common supplies and services, such as transportation, mail, and travel management, to federal agencies, but IFMS' vehicle and equipment purchases account for most of the FSS' spending on capital assets. IFMS and the FSS's supply operations are funded through a revolving fund, the General Supply Fund (GSF). IFMS differs from other case studies with revolving funds because it is more dependent on the retention of proceeds from asset disposal.

Fixed Assets Acquired

IFMS acquires and manages several types of vehicles for other federal agencies, with sedans and light trucks constituting the majority of the fleet. IFMS' 700 FTEs oversee a fleet of 145,000 vehicles. Although federal agencies are not required to obtain vehicles through IFMS, about 50 percent of all vehicles used by federal agencies are supplied by IFMS.[1]

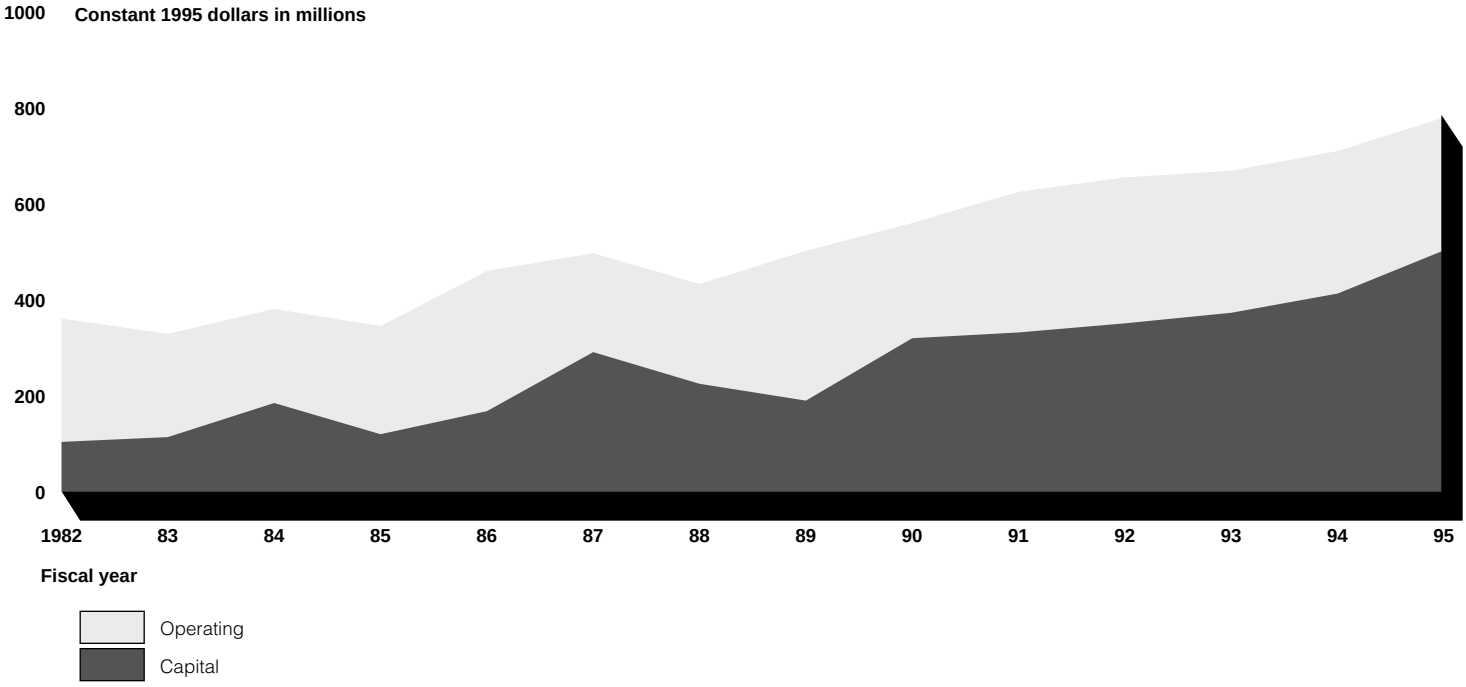
Capital Spending Trends

Although IFMS operating obligations were nearly equal to or exceeded capital obligations in real terms during the early and mid 1980s, figure IV.1 shows that capital obligations have consistently exceeded operating obligations since fiscal year 1990.[2] IFMS obligations for capital in fiscal year 1995 were $502 million, nearly five times as high as the real 1982 level. In contrast, IFMS obligations for operating expenses grew relatively little over the period; operating obligations were $256 million in fiscal year 1982 and $277 million in fiscal year 1995.

[1]This figure excludes vehicles used by the Postal Service.

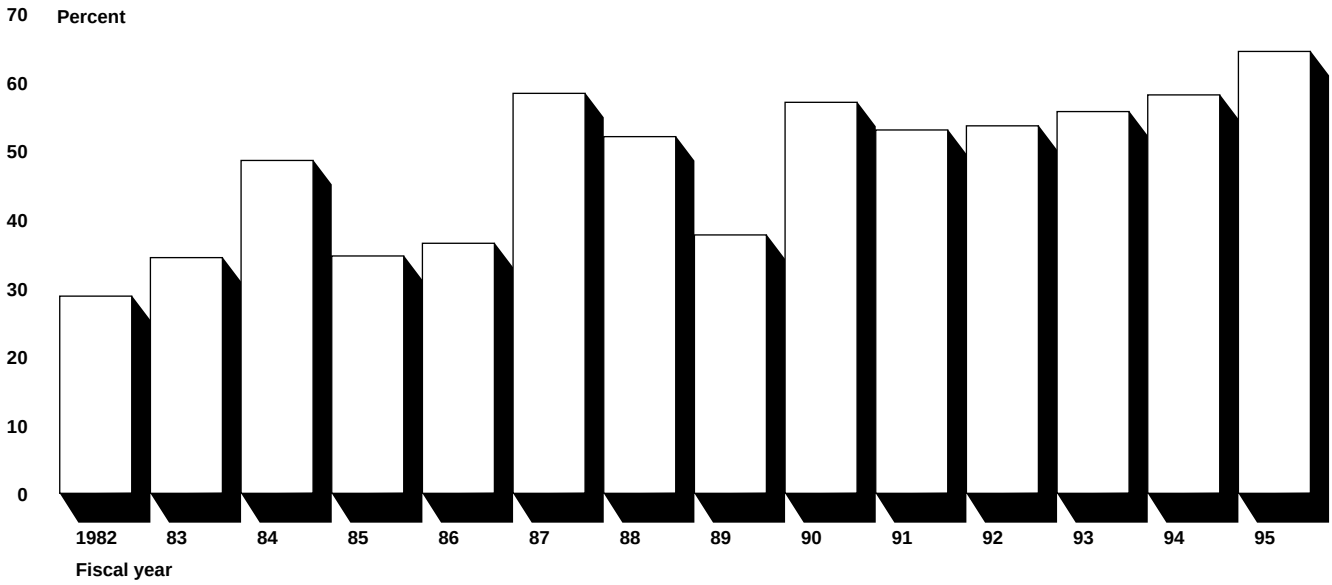
[2]Capital obligations as referred to in figures IV.1 and IV.2 are not necessarily equivalent to our definition of capital. IFMS capital obligations are those for the line item "Fleet management: purchase of equipment" as reported in the GSF's program and financing schedule in the appendix to Budget of the United States Government, Fiscal Year 1997. (See chapter 1 for more information on the program and financing schedule and the limitations of this data.) Operating obligations correspond to the line item "Fleet management" as reported in the GSF's program and financing schedule in the appendix to Budget of the United States Government, Fiscal Year 1997.

Figure IV.1: IFMS Capital and Operating Obligations for Fiscal Years 1982 Through 1995



As a result, the portion of IFMS obligations dedicated to capital is consistently higher after fiscal year 1990. (See figure IV.2.) Since 1990, capital as a portion of total obligations has remained above 50 percent. Fiscal year 1995 capital obligations represented a 14-year high of 64 percent of total obligations.

Figure IV.2: IFMS Capital Obligations as a Percent of Total Obligations for Fiscal Years 1982 Through 1995



Sources and Uses of Funding

User charges and disposal proceeds are deposited into the GSF and used to maintain and regularly replace vehicles. Agencies are charged for the use of IFMS vehicles under a full-cost-recovery pricing system. IFMS recovers depreciation, maintenance, and inflation costs from fleet users. According to IFMS' fiscal year 1995 capital outlay plan, user charges provided about three-quarters of IFMS 1995 income; the remaining quarter was primarily generated from vehicle disposal.

IFMS has also received advances from the Department of Energy (DOE) to acquire alternatively fueled vehicles under the Energy Policy Act of 1992. This act requires that by fiscal year 1999, alternatively fueled vehicles must make up at least 75 percent of the total number of new vehicles acquired by the federal fleet. The law stipulates that DOE is to fund the incremental cost of acquiring alternatively fueled rather than conventionally fueled vehicles.

The GSF is intended to be a self-sustaining revolving fund and is not designed to generate any significant profit. Any operating profits that

exceed identified capital requirements of the fund in a given fiscal year are not available to the GSF and are returned to the Treasury.[3]

Capital Planning and Budgeting Process

Beginning in January of the preceding fiscal year, local IFMS fleet managers consult with customers to forecast fleet needs for the upcoming fiscal year. The budget and accounting staff of the IFMS and FSS also forecast needs by querying an automated system of vehicle usage history. IFMS management and FSS budget and accounting staff compare their forecasts and negotiate a capital outlay plan, which is part of the FSS Financial Plan. The capital outlay plan displays monthly projections of the fleet's capital income and outlays for the current and upcoming fiscal year. The outlay plan's income components are: prior-year funding authority,[4] advances from other agencies for designated procurements, depreciation, inflation, vehicle disposal, and recovery for vehicles destroyed in accidents. Outlays for vehicle acquisition are offset against these income components to derive capital availability.[5] The FSS Financial Plan must be approved by the GSA Comptroller and the GSA Chief Financial Officer prior to the beginning of each fiscal year.

Although the IFMS and the supply component operate independently within the GSF, one component can borrow from the other if cash shortfalls occur. For example, IFMS has borrowed from the supply component of GSF to accommodate spikes in payments to vendors. Purchases and payments are concentrated in a few months of the year to obtain favorable prices and accommodate manufacturer's production schedules, but IFMS customers are billed bimonthly. When IFMS has not accumulated enough income to make payment for the purchases, IFMS has borrowed from the supply component of GSF and repaid in subsequent months as fleet income was collected.

Response to OMB Bulletin 94-08

IFMS officials submitted the required 5-year plan and explanation of its planning and budgeting process in response to OMB Bulletin 94-08. They were easily able to provide the requested information, except for data beyond the budget year, from the FSS Capital Outlay Plan. IFMS officials do not regularly prepare out-year estimates due to the volatility and

[3]Virtually all identified capital requirements relate to fleet operations.

[4]Prior-year funding authority is budget authority from previous years that has not been obligated.

[5]Operating and overhead costs (including maintenance) are not shown on the capital income plan. These costs appear on the fund's income and expense statements.

uncertainty of the vehicle market and future needs, and do not believe that the out-year projections submitted for the Bulletin are reliable.

The Public Buildings Service

The Public Buildings Service (PBS) is the component of the General Services Administration (GSA) responsible for providing and maintaining work space for federal agencies. Since 1975, PBS activities have been financed through a revolving fund, the Federal Buildings Fund (FBF). Unlike the other revolving funds in this study, the FBF cannot retain proceeds from the disposal of assets. The Congress has also placed restraints on the generation and use of FBF income. Therefore, FBF does not fully function as a business-type revolving fund.

Fixed Assets Acquired

PBS owns and leases general- and special-purpose work space such as office buildings, courthouses, and laboratories. In 1994, PBS employed approximately 9,000 FTEs to manage 1,776 government-owned buildings and leased space in 6,421 buildings. Through PBS, GSA manages more office property than any other civilian agency.[1] In 1994, PBS leased about half of the office space it provided.

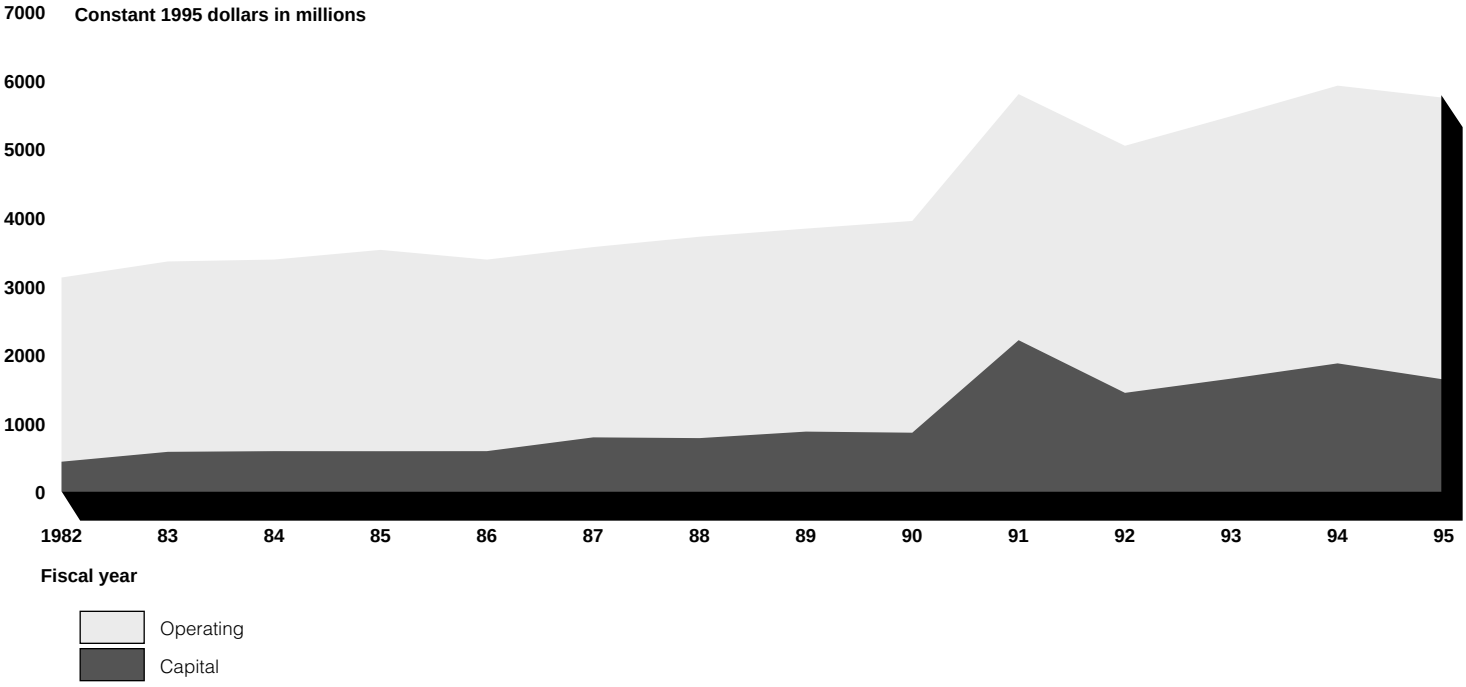
Capital Spending Trends

As shown in figure V.1, FBF total annual obligations in real dollars were significantly higher during fiscal years 1991 through 1995 than during fiscal years 1982 through 1990; capital obligations have contributed to this growth.[2] Although both capital and operating obligations increased steadily in real terms during the 1980s, capital obligations have nearly doubled since 1990 to $1.6 billion in fiscal year 1995. Operating obligations were $3.1 billion in fiscal year 1990 and $4.1 billion in fiscal year 1995.

[1]Although some agencies have authority to obtain their own work space, GSA is the mandatory supplier of office space for most federal agencies.

[2]Capital obligations as referred to in figures V.1 and V.2 are not necessarily equivalent to our definition of capital. PBS capital obligations are obligations for "Capital investment" as reported in the FBF's program and financing schedule in the appendix to Budget of the United States Government, Fiscal Year 1997. (See chapter 1 for more information on the program and financing schedule and the limitations of this data.) PBS operating obligations are total gross obligations less capital obligations.

Figure V.1: PBS Capital and Operating Obligations for Fiscal Years 1982 Through 1995



Capital obligations have increasingly represented more of the FBF's total obligations since the early 1990s. (See figure V.2.) During fiscal years 1982 through 1995, capital obligations as a percent of total obligations generally increased gradually from 14 percent in 1982 to 28 percent in 1995 with one exception. In fiscal year 1991, capital obligations rose to 38 percent of total obligations largely because the FBF received a $1.4 billion appropriation for courthouse construction.

Figure V.2: PBS Capital Obligations as a Percent of Total Obligations for Fiscal Years 1982 Through 1995

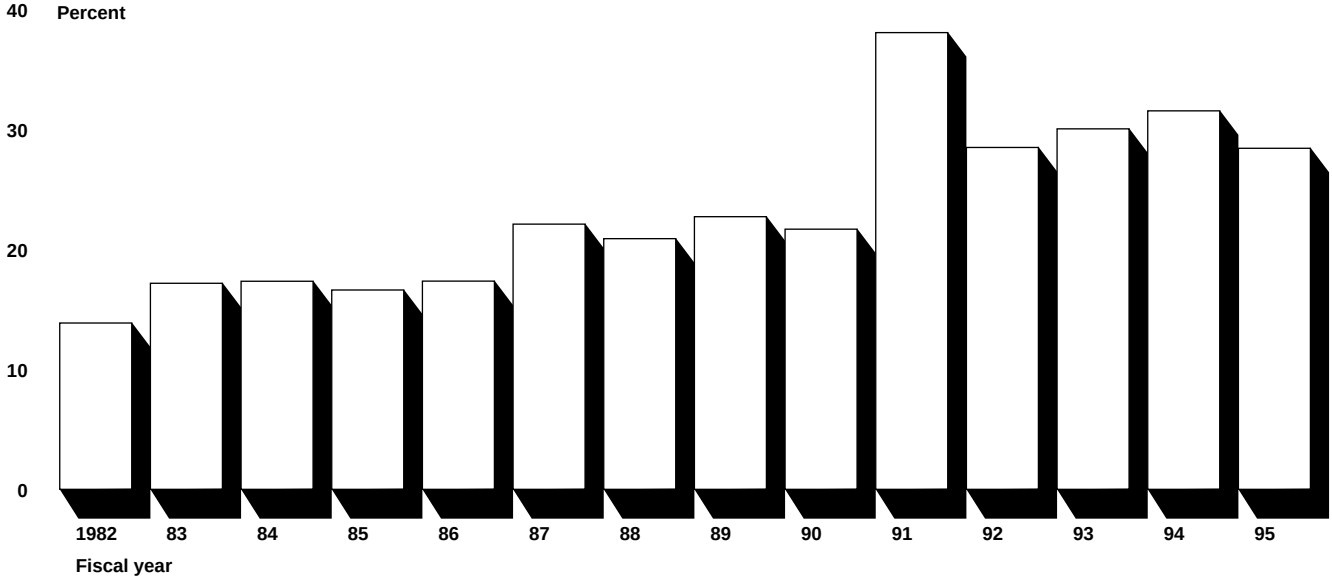
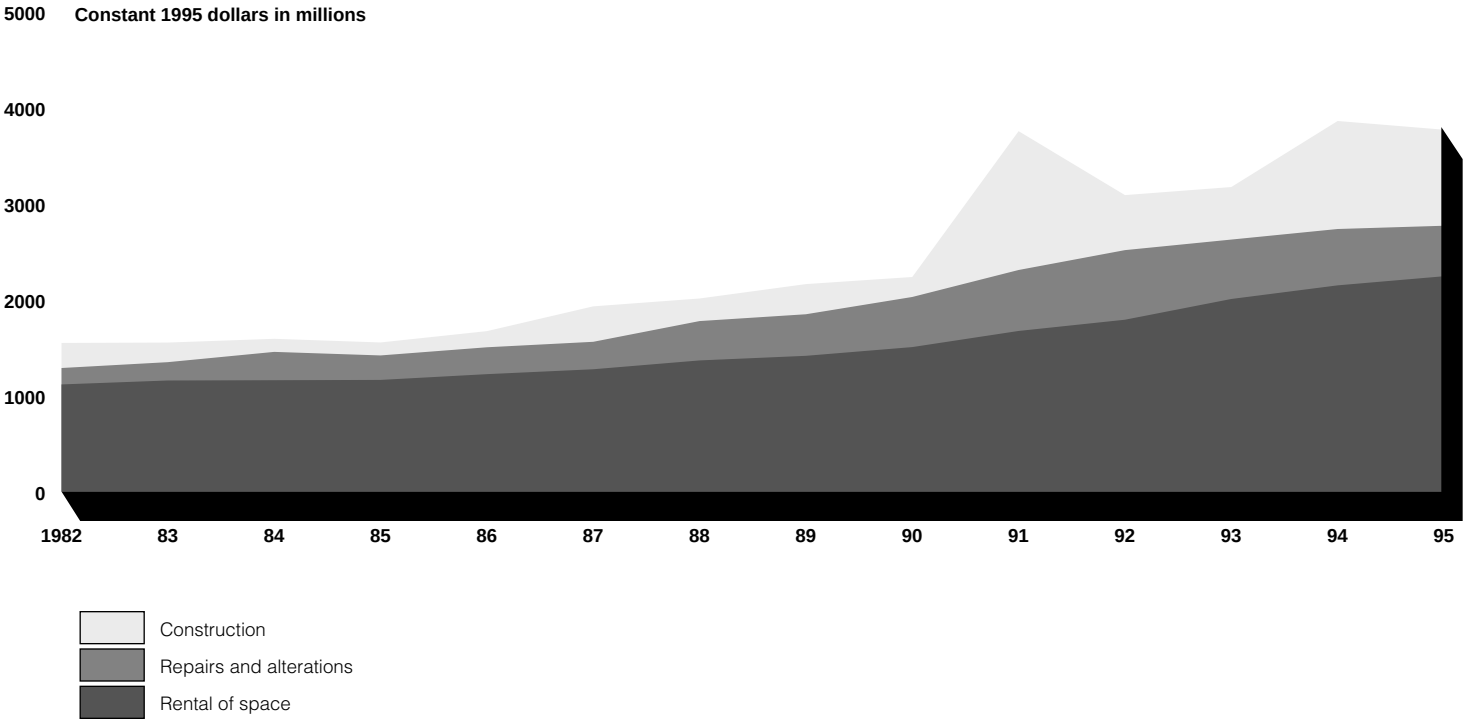


Figure V.3 shows the composition of FBF obligations for the FBF's largest operating component, rental of space, and two large capital items, construction and repairs and alterations.[3] While obligations for rent increased steadily between fiscal years 1982 and 1995, obligations for construction have fluctuated significantly. As noted above, FBF received a significant appropriation for courthouse construction in fiscal year 1991, and demands for courthouse construction continue.

[3]Construction represents the sum of the program and financing schedule line items, "Construction and acquisition of facilities," "Design and construction services," and "Construction of lease purchase facilities." Repairs and alterations and rental of space are discrete line items in the program and financing schedule.

Figure V.3: PBS Obligations for Construction, Repairs and Alterations, and Rental of Space From Fiscal Years 1982 Through 1995



Sources and Uses of Funding

The FBF receives funding from three sources: agency rent charges, appropriations, and borrowing authority. Most agencies are charged rent for the use of PBS owned or leased space based on periodic appraisals of the market value of the space, not on PBS' actual cost to rent or own the space. Although FBF was designed to collect enough rental income to pay lessors, maintain owned work space, and sustain a limited amount of new construction, a recent and large demand for courthouse construction has exceeded the resources available to the fund from user fees. Therefore, expansion of PBS' inventory has had to be partially funded through appropriations. Appropriations funded about half of PBS' construction projects in fiscal year 1995.

Unlike some other revolving funds, the FBF cannot retain proceeds from disposal of PBS assets. Although PBS has authority to dispose of surplus property, by law all proceeds must be deposited into a land and water

conservation fund.[4] Disposal proceeds are not large due to the relatively low volume of disposal and laws that require GSA to give nonprofit groups first choice of surplus properties.

FBF funds are used to repair and maintain work space, to purchase or construct work space, to make payments to lessors, and to repay loans from the Federal Financing Bank (FFB).[5] Repair and maintenance funding levels are driven by PBS policies and overall funding levels. PBS policy gives basic repairs, such as elevator maintenance, first priority for funding. Minor repairs, such as replacing an elevator motor, receive second priority. Major modernization, such as elevator replacement, receives third priority. Although PBS has established a goal of making minor repairs worth 2 percent of inventory replacement value and major modernization on 5 percent of property square footage each year, PBS does not necessarily achieve these rates. Overall funding levels, urgency, and rates of return determine which repairs and maintenance projects will be undertaken. Similarly, new work space is constructed or purchased when less costly than leasing and where funding is available. However, PBS officials said that recent funding levels have limited construction projects primarily to courthouses, border stations, and work space that cannot be leased commercially.

Capital Planning and Budgeting Process

PBS uses a community planning process to determine long-range needs for the acquisition and maintenance of space. PBS' regions identify long-range space needs for 44 major communities[6] every 2 years and for minor communities[7] as needed. The community plans are developed through dialogue between PBS clients, regions, and headquarters and are reviewed by GSA's portfolio management group. Once the plans are finalized, the Planning Advisory Committee of GSA officials reviews all of the planned projects for the budget year. Based on income projections and space needs, the committee recommends a budget-year program to the PBS Commissioner and Deputy Commissioner. After approval from the PBS Commissioner and Deputy Commissioner, the plan is sent to the GSA Administrator for approval. Once approved, national headquarters staff of each client agency are asked to review the plan for any omissions or needed changes.

[4]The same law also prevents PBS from retaining income from leases to non-federal entities.

[5]The Congress authorized GSA to borrow from FFB to construct office space during the 1970s.

[6]PBS defines major communities as those having at least 1 million square feet of PBS space.

[7]Minor communities are those having less than 1 million square feet of PBS space.

The community planning process forms the basis for the long-range plans PBS provides to OMB. Prior to fiscal year 1996, PBS used its community plans to periodically prepare 5-year plans for OMB. For fiscal years 1996 and 1997, PBS' response to OMB Bulletins 94-08 and 95-03 effectively replaced the previous 5-year plans. However, these responses have much less detail than PBS' previous capital plans. For example, the OMB Bulletin requires identification of specific capital projects in the current and budget year only, although PBS formerly had been identifying projects in all 5 years.

The Congress annually appropriates all FBF funding, including the income received from client agencies. To decide how FBF income will be used, FBF's authorizing and appropriations subcommittees review prospectuses for each construction or acquisition project in excess of $1.81 million or any lease alteration project with an estimated cost of at least $0.905 million. A prospectus justifies the method of acquisition and provides detailed cost estimates. The GSA Administrator can annually increase the prospectus thresholds based on the Department of Commerce's Construction Index. After the FBF budget is enacted, PBS must seek congressional approval from its appropriations subcommittees to reprogram 10 percent or more of funds allocated for specific FBF activities. Any transfers between the FBF and other accounts require congressional approval.

The Congress has controlled FBF income by limiting the rental payments of some client agencies. During the 1980s, the Congress believed some PBS rental charges were too high and began to impose caps on the rents of some agencies. Although only three agencies currently have rent caps, PBS estimates substantial income loss over the years from these caps.

Response to OMB Bulletin 94-08

PBS submitted the required 5-year plan and an explanation of PBS' goals, new proposals, and planning processes in response to Bulletin 94-08. The 5-year plan projected outlays for the acquisition of general purpose office buildings, courthouses, border stations, and laboratories. Financial plans outlining PBS' proposals to reduce the proportion of leased property and to repair existing government-owned space accompanied the 5-year plan.

Having produced 5-year capital plans in the past, PBS officials stated that most of the information for the Bulletin was readily assembled. Although PBS 5-year plans produced prior to Bulletin 94-08 contained more detail about specific projects than was requested by the Bulletin, the response contained PBS' first attempt to project outlays over the 5-year period. PBS

officials felt that the Bulletin encouraged their efforts to focus on multiyear financial planning and the type of space being acquired. PBS officials also believed the Bulletin could help address scoring issues that have concerned them.

The U.S. Geological Survey

The U.S. Geological Survey (USGS) is a bureau of the Department of the Interior that conducts research and provides basic scientific information regarding natural resources and hazards. Until fiscal year 1995, scientific equipment purchases were funded solely from USGS' annual appropriations account, Surveys, Investigations, and Research (SIR). In fiscal year 1995, the Congress expanded USGS' Working Capital Fund (WCF) account to include an "investment component" to partially fund laboratory operations, facilities improvements, and equipment replacement. Agency managers can make contributions from annual SIR appropriations to this "investment component" for a future purchase of scientific equipment. The investment component is unique among the financing mechanisms of our case studies because it allows managers to voluntarily save for fixed-asset purchases.

Fixed Assets Acquired

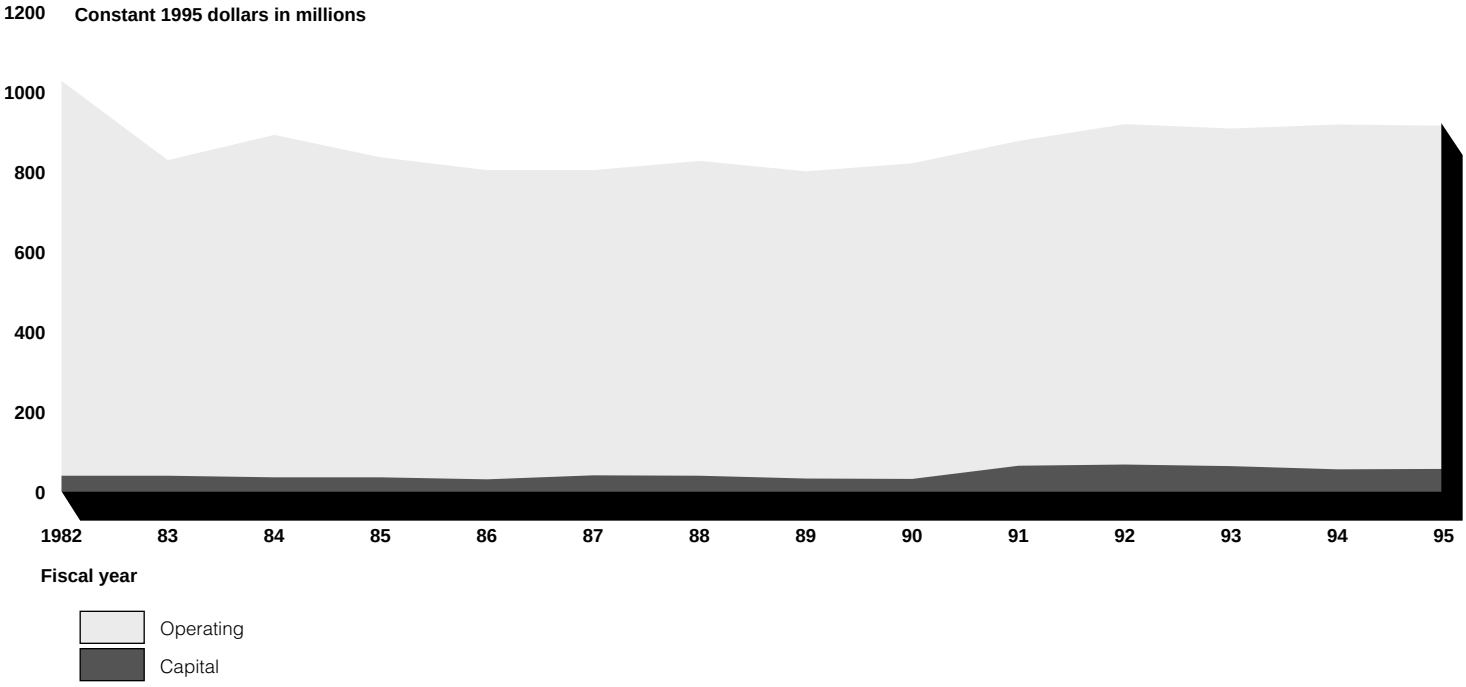
USGS acquires telecommunications equipment, information systems, and research and scientific equipment. In fiscal year 1995, USGS obligated a total of $51 million from the SIR and WCF accounts for the acquisition of equipment. Some USGS equipment is shared with states and universities to offset USGS' costs.

Capital Spending Trends

As shown in figure VI.1, USGS' operating obligations were significantly greater than capital obligations in real dollars from fiscal year 1982 through fiscal year 1995.[1] Although operating obligations varied little since 1983, capital obligations doubled from fiscal years 1990 through 1991 to $64 million and fell to $56 million in 1995.

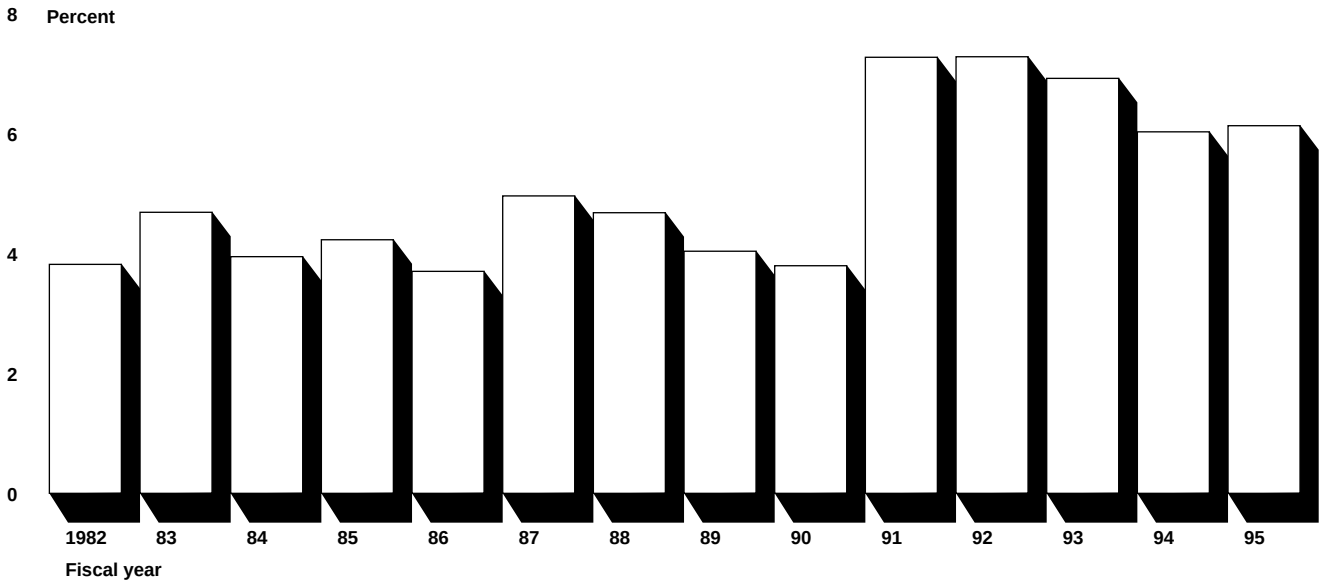
[1]Capital obligations as referred to in figures VI.1 and VI.2 are not necessarily equivalent to our definition of capital. Capital obligations are the sum of USGS' obligations for object class 31.0, "equipment," and object class 32.0, "land and structures" as reported in the appendix to Budget of the United States Government, Fiscal Year 1997. (See chapter 1 for more information on object class and the limitations of this data.) Operating obligations are total gross obligations less capital obligations.

Figure VI.1: USGS Capital and Operating Obligations for Fiscal Years 1982 Through 1995



Between 1982 and 1995, USGS spent about 7 percent or less of its total obligations on capital. (See figure VI.2.) Capital obligations as a percent of total obligations fluctuated during this time between a low of 3.7 percent in fiscal year 1986 and a high of nearly 7.3 percent in 1992.

Figure VI.2: USGS Capital Obligations as a Percent of Total Obligations for Fiscal Years 1982 Through 1995



Sources and Uses of Funding

USGS primarily funds capital acquisitions from two accounts: Surveys, Investigations, and Research (SIR) and the Working Capital Fund (WCF).

SIR

About two-thirds of SIR funding is appropriated; the remaining third comes from fees charged to federal agencies and states. SIR funding is used to carry out such programs and activities as: national mapping, geography, and surveys; geologic and mineral resource surveys and mapping; water resources investigations; general administration; and facilities. Some equipment purchases are made from this account, but approximately 80 percent of SIR funds are currently consumed by salaries and rent. USGS can reprogram the lesser of $500,000 or 10 percent of a line item within the SIR account.

WCF

The WCF has two primary component types: fee-for-service and investment. The fee-for-service component includes the National Water Quality Laboratory (NWQL) and the Washington Administrative Service Center (WASC). NWQL and WASC users are assessed a fee to fund the operations of these organizations and eventual replacement of their assets. The investment component of the WCF includes a mainframe computer,

telecommunications, equipment, and facilities. The mainframe computer and telecommunications are funded through fee assessments, but equipment and facilities are funded through planned, voluntary contributions from the SIR account.[2]

Capital Planning and Budgeting Process

Each division within USGS has its own process for developing a budget and a financial and operating plan. The investment plan is intended to be the link between division budgets and the WCF investment component.

Fixed assets can be funded directly through SIR, or the investment component of WCF, or a combination of both.[3] USGS units may choose to fund equipment through WCF contributions if the item is very expensive or is not immediately needed. If a unit decides to purchase an asset through WCF, an investment plan is prepared that specifies the goods or services to be acquired, the estimated acquisition or replacement cost, the number of years required to fund the acquisition, and the schedule of deposits into the fund (annually, semiannually, quarterly, or monthly). Units are not required to fund the full acquisition cost of the asset through WCF contributions; units can fund any portion of the cost directly through SIR.

USGS has placed restrictions on the use of the investment component to reflect congressional intentions regarding use of the WCF. For example, all investment plans must be approved by the delegated authority within the respective division or the bureau. Contributions must be made for at least 2 years with purchase occurring in the third year or thereafter, and WCF contributions may not be used for the construction of buildings.

Response to OMB Bulletin 94-08

USGS did not submit a 5-year plan in response to the Bulletin but did describe its WCF. A 5-year plan was not submitted because USGS' individual equipment purchases were not large enough to meet the Bulletin's reporting threshold. USGS noted that two of its largest, fixed-asset purchases had been previously and extensively reviewed by OMB.

[2]Throughout this report, we use the term "investment component" to refer only to those elements of the WCF that are funded through planned, voluntary contributions.

[3]Because the investment component is relatively new and voluntary and because operating budgets may be strained, it is uncertain how often managers will use this component.

Major Contributors to This Report

Accounting and Information Management Division, Washington, D.C.

Christine E. Bonham, Assistant Director
C. Bernard Myers, Evaluator-in-Charge
Laura E. Hamilton, Evaluator

Office of the General Counsel

Chuck Roney, Assistant General Counsel
Edda Emmanuelli-Perez, Senior Attorney

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted, also. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000
or by using fax number (301) 258-4066, or TDD (301) 413-0006.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

info@www.gao.gov

or visit GAO's World Wide Web Home Page at:

http://www.gao.gov

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested