

September 2003

DEPOT MAINTENANCE

DOD's 50-50 Reporting Should Be Streamlined





Highlights of GAO-03-1023, a report to Congressional Committees

Why GAO Did This Study

Under 10 U.S.C. 2466, not more than 50 percent of each military department's annual depot maintenance funding can be used for work done by private-sector contractors. The Department of Defense (DOD) also must submit two reports to the Congress annually on the division of depot maintenance funding between the public and private sectors—one about the percentage of funds spent in the previous 2 fiscal years (prior-years report) and one about the current and 4 succeeding fiscal years (future-years report). As required, GAO reviewed the two DOD reports submitted in early 2003 and is, with this report, submitting its views to the Congress on whether (1) the military services met the so-called "50-50 requirement" for fiscal years 2001-2 and (2) the projections for fiscal years 2003-7 are reasonable estimates. GAO also identified opportunities to improve the reporting process.

What GAO Recommends

GAO suggests that the Congress consider amending 10 U.S.C. 2466 to require only one annual 50-50 report to cover the prior, current, and budget years for which data are generally more reliable and potential impacts more immediate. GAO also recommends that DOD improve 50-50 data collection and validation by, among other actions, using service audit agencies for timely review and validation of 50-50 data. DOD concurs with the report recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-03-1023.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barry W. Holman at (202) 512-5581 or holmanb@gao.gov.

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DOD's 50-50 Reporting Should Be Streamlined

What GAO Found

Continuing weaknesses in DOD's data gathering, reporting processes, and financial systems prevented GAO from determining with precision if the military services complied with the 50-50 requirement in fiscal years 2001-2. DOD data show all the services, except the Air Force in fiscal year 2001, to be below the 50-percent funding limit on private sector work. However, as before, GAO found errors in the data that, if corrected, would overall increase funding of the private sector and move each service closer to the contract limit. For example, for fiscal year 2002, the Navy did not include about \$401 million in private sector maintenance work on aircraft carriers and surface ships. Correcting for these and other errors would increase the Navy's percentage of private sector depot maintenance funds for that year from the 42.6 percent reported to 46.9 percent. Such data weaknesses show that prior-years reports do not precisely measure the division of maintenance funding. At best, over time these results provide rough approximations and indicate trends that may be useful to decision makers.

Because of data deficiencies and changing budget projections, the future-years report does not provide reasonable estimates of public and private sector maintenance funding for fiscal years 2003-7 and limits its usefulness to decision makers. GAO reported this shortcoming in the past, and problems continue. For example, the Army underreported maintenance work at nondepot locations as it continues to consolidate the work and better control it at such locations. Other Army work was not reported because some commands did not receive guidance and others misapplied it. These errors would add about \$200 million annually to the Army's future estimate and increase the percent of projected funding in the private sector.

Opportunities still exist for improvements, including for streamlining the 50-50 reports, continued service audit agency support, and data development. Streamlining the 50-50 reports could help address problems caused by, among other factors, inexact program estimates. Second, although DOD is concerned that recent revisions to federal audit standards could keep service auditors from further participation in the 50-50 process, GAO believes that a way can be developed to enable auditors' continued support yet ensure their independence. Third, data development could be helped by better disseminating guidance and training participating personnel.

DOD's Reported Fiscal Year 2002 50-50 Data and GAO's Adjustments

Numbers in percent

Service	Public work reported	Public work adjusted	Private work reported	Private work adjusted
Army	51.5	49.2	46.5	49.0
Navy/Marine Corps	54.5	50.3	42.6	46.9
Air Force	54.1	51.4	45.8	48.5

Source: GAO analysis of DOD data.

Note: Totals reported and adjusted will not equal 100 percent due to rounding and legislatively excluded public-private partnerships.

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Abbreviations

- DOD Department of Defense
OSD Office of the Secretary of Defense

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**United States General Accounting Office
Washington, DC 20548**

September 15, 2003

The Honorable John Warner
Chairman
The Honorable Carl Levin
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Duncan Hunter
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

Under 10 U.S.C. 2466, not more than 50 percent of annual depot maintenance funding provided to the military departments and defense agencies can be used for work accomplished by private-sector contractors. Section 2466 also directs the Department of Defense (DOD) to submit two annual reports to the Congress on the distribution of depot maintenance funding between the public and private sectors. The first report is to identify the percentage of funds expended by each military department and defense agency during the preceding 2 fiscal years for the performance of depot maintenance workloads by the public and private sectors (the “prior-years report”). The second report is to project the same information for the current and 4 succeeding fiscal years (the “future-years report”). For 2003, DOD issued the prior-years report on February 11, 2003, and the future-years report on April 7, 2003.

Section 2466 also requires us to submit our views to the Congress on whether DOD complied with the so-called “50-50 requirement” in the prior-years report and whether the projections in the future-years report are reasonable. Accordingly, this report discusses whether (1) the military departments met the 50-50 requirement for fiscal years 2001 and 2002 and (2) the projections for fiscal years 2003 through 2007 represent reasonable estimates. As part of our work, we also identified opportunities to improve the reporting process. To accomplish these objectives, we analyzed the 50-50 reported data and each service’s procedures and internal management controls for collecting, aggregating, and validating depot maintenance information for purposes of responding to the section 2466

requirements. We limited our analysis of future-years data because initial audit efforts identified significant continuing problem areas, similar to those found in prior audits, that are not likely to change.

Results in Brief

Continuing weaknesses in DOD's data gathering, reporting processes, and financial systems prevented us from determining with precision whether the services were in compliance with the 50-50 requirement for fiscal years 2001 and 2002. DOD's data as submitted to the Congress shows the military departments to be below the 50-percent funding limitation on private sector work, except for the Air Force, which for 2001 reported itself above the limit¹ but below it in 2002. However, as in past years, we found errors and omissions in the data that, if corrected, would overall increase the percentages of funding going to the private sector and move each department closer to the contract limit. For example, in its data for fiscal year 2002, the Navy did not include about \$401 million in private sector maintenance work on aircraft carriers accomplished during the same time as nuclear refueling and on surface ships being placed in an inactive status. The Marine Corps, which compared to the other services has the smallest workload but the largest proportion of errors, did not report most depot maintenance workloads from the command responsible for system acquisitions and upgrades, understating private-sector workloads by about \$32 million and public sector workloads by about \$7 million. Correcting for these and other errors we found would increase the Department of the Navy's percentage of depot funds for work accomplished in the private sector during fiscal year 2002 from the 42.6 percent reported to 46.9 percent, a gain of over 4 percentage points. These weaknesses indicate the data in the prior-years report cannot be relied on to provide a precise measure of the balance of funding between the public and private sectors for the military departments. At best, over time these reports provide rough approximations of the public-private funding allocations, with some indications of trends that may be useful information to the Congress in exercising its oversight role and to DOD officials in managing the depot maintenance program.

Because of supporting data deficiencies and the changing nature of budget projections, the future-years report does not provide reasonable estimates

¹ The Secretary of the Air Force issued a national security waiver for fiscal year 2001 as provided by 10 U.S.C. 2466(b) at that time. This provision was subsequently amended (sec. 341, P.L. 107-107, Dec. 28, 2001) to designate the Secretary of Defense as the waiver authority instead of the secretaries of the military departments.

of public and private sector depot maintenance funding allocations for fiscal years 2003 through 2007, thereby limiting its usefulness to congressional and DOD decision makers. We have reported this shortcoming with the future-years report in the past, and the problems continue to occur. For example, as in past years, the Army underreported public and private sector depot-level maintenance work at field locations as it continues unfinished efforts to consolidate maintenance activities and better control the proliferation of depot-level tasks at nondepot locations. Other Army work was not reported because some commands did not receive 50-50 guidance and others misapplied the guidance. While the Army's supporting documentation for the projected data was inadequate, errors and omissions of similar magnitude to the prior years data would add more than \$200 million annually to the Army's reported future work for both public and private sectors. As with the prior years, the net effect of the problems we found generally increases the percentage of workload expected to be accomplished by the private sector. Besides reporting errors, other internal and external factors can create large fluctuations in reported data, which in turn can provide a distorted and misleading view to outside observers about efforts to remain compliant with the 50-50 requirement. For example, in the current future-years report, the Air Force's projected public sector work financed through the working capital fund is \$3.0 billion higher than the amount reported for the same 4-year time period in the future-years report submitted in 2002. Although this would appear to indicate a large influx of new work to the public depots, in reality the amount of work, according to budget estimates and management reports, is expected to remain fairly level during this reporting period in terms of production hours and size of workforce. Most of the dollar (and percentage) increase in public sector work is the result of price hikes in the sales rate charged to its customers, a condition primarily caused by increases in the cost of spare and repair parts used in the maintenance process.

Recently DOD's improvements in 50-50 guidance and operating processes have reached a plateau in terms of quality and direction. However, opportunities still exist to improve 50-50 data and management processes and controls, including through a streamlined 50-50 report, service audit agency participation in that process, and an improved data development process. Streamlining the 50-50 report to focus on the data that are likely to be more accurate and extending the time DOD officials have to put the data together should improve the quality of the reported 50-50 data. Furthermore, DOD officials indicated their concerns that the issue of auditor independence, arising from a recent revision of government auditing standards, could keep service auditors from further participation

in 50-50 reviews. However, the continued participation of the service audit agencies—to verify data and identify errors to be corrected by 50-50 managers before reports are submitted to the Congress—is critical to improving data accuracy and completeness. We believe that, as such participation by auditors has been done with regard to the base realignment and closure process, a process can be developed to enable service auditors' valuable participation to continue while the services are compiling their data, with audit agencies still maintaining their independence. Lastly, opportunities for improvement in the data development process include better dissemination of guidance and enhanced training for personnel who collect and report the data.

We are including a matter for congressional consideration regarding the streamlining of the 50-50 reports by reducing the number of years of future data that are collected and combining the prior-year and future-year reports into one report with a later reporting date. We are also making recommendations to the Department of Defense for improving the 50-50 data reported to the Congress (1) by assuring the timely participation of the service audit agencies in reviewing the data before reports are submitted to the Congress and (2) by increasing management's attention to the dissemination of guidance to all organizations and personnel participating in the process and to the improvement of training for personnel responsible for developing and aggregating data.

In written comments on a draft of this report, DOD concurred with the report's recommendations while disagreeing with limited portions of our analyses. The department's comments are included in appendix III.

Background

Governing Legislation and Previous Reports Concerning the 50-50 Requirement

In addition to the 50-50 requirement in 10 U.S.C. 2466, two other title 10 provisions directly affect the reporting of workload allocations to the public and private sectors.

- Section 2460 defines depot maintenance to encompass material maintenance or repair requiring the overhaul, upgrade, or rebuilding of parts, assemblies, or subassemblies and the testing and reclamation of equipment, regardless of the source of funds or the location at which maintenance or repair is performed. Depot maintenance also

encompasses software maintenance, interim contractor support,² and contractor logistics support³ to the extent that work performed in these categories is depot maintenance. The statute excludes from depot maintenance the nuclear refueling of an aircraft carrier, the procurement of major modifications or upgrades of weapon systems, and the procurement of parts for safety modifications, although the term does include the installation of parts for safety modifications.

- Section 2474 directs DOD to designate public depots as Centers of Industrial and Technical Excellence and to improve their operations so as to serve as recognized leaders in their core competencies.⁴ Section 342 of the National Defense Authorization Act for Fiscal Year 2002 (P.L. 107-107, Dec. 28, 2001) amended this statute to exclude qualifying public-private partnerships⁵ from the 50-percent funding limitation on contracting in section 2466. Section 342 provides that the funds expended for the performance of depot-level maintenance by nonfederal government personnel located at the centers shall not be counted when applying the 50-percent limitation if the personnel are provided pursuant to a public-private partnership. This exclusion initially applied to depot maintenance funding for fiscal years 2002 through 2005. Section 334 of the National Defense Authorization Act for Fiscal Year 2003 (P.L. 107-314, Dec. 2, 2002) extended this period to include all contracts entered into through fiscal year 2006.

The Office of the Secretary of Defense (OSD) has issued guidance to the military departments for reporting public-private workload allocations.

² Interim contractor support is designed to be an interim support arrangement in which a contractor provides depot maintenance (and sometimes other logistics support) as part of the acquisition strategy for new systems.

³ Contractor logistics support is designed to be a lifetime support concept in which a contractor provides most or all elements of logistics support, including depot maintenance.

⁴ Core competencies are depot-level maintenance capabilities to be retained in public depots to meet defense strategic and contingency plans and for which the military departments believe that DOD should be a recognized leader in the national technology and industrial base.

⁵ DOD guidance defines a public-private partnership for depot maintenance as an agreement between a public-sector depot maintenance activity and one or more private industry or other entities to perform work or utilize facilities and equipment. Such an arrangement includes use of public facilities, equipment, and employees to perform work for the private sector under certain defined circumstances; private-sector use of public-sector equipment and facilities to perform work for the public sector; and work-sharing agreements using both public- and private-sector facilities and/or employees.

The guidance is consistent with the definition of depot-level maintenance and repair in 10 U.S.C. 2460.⁶ The military departments have also issued internal instructions to manage the data collection and reporting process, tailored to their individual organizations and operating environments.

Based on the congressional mandate regarding the DOD 50-50 requirement, this is the sixth year that we have reported on the prior-year numbers and the fourth year reporting on the future-year numbers.⁷ In past years, we have reported on continuing data errors and inconsistencies in reporting by the military departments and problems in documenting and independently validating 50-50 data. We have recommended increasing management attention to and emphasis on the 50-50 reporting process, improving guidance in specific maintenance categories, and implementing better internal controls. We have also observed that the 50-50 process is complex, involving numerous reporting entities and commands, and requiring the incorporation of evolving new concepts of logistics support, changing locations and organizations for accomplishing depot maintenance, and changes in statutory provisions. Service officials told us that the reporting process is somewhat burdensome and time frames for collecting data are constrictive. Further complications in reporting result from relatively high turnover in staff responsible for collecting and managing data and uneven management attention and priority accorded the 50-50 process.

Our work has historically been augmented by the efforts of the service audit agencies, which have participated in the 50-50 processes in varying degrees. We have recommended the continued involvement of the auditors to review and validate reporting processes and results and to correct substantial errors and omissions before the 50-50 data are submitted to the Congress.

⁶ Because of the difficulty of segregating installation costs for safety modifications from costs for installing other modifications (e.g., for improved performance), OSD's guidance specifies that all modification installation costs be reported when an installation is considered to be a depot-level service.

⁷ For the two most recent reports, see U.S. General Accounting Office, *Depot Maintenance: Change in Reporting Practices and Requirements Could Enhance Congressional Oversight*, GAO-03-16 (Washington, D.C.: Oct. 18, 2002) and *Depot Maintenance: Management Attention Required to Further Improve Workload Allocation Data*, GAO-02-95 (Washington, D.C.: Nov. 9, 2001). Other related GAO products are listed at the end of this report.

Our prior reports also recognized the limitations of DOD's financial systems, operations, and controls. Our audits of DOD's financial management operations have routinely identified pervasive weaknesses in financial systems, operations, and internal controls that impede its ability to provide useful, reliable, and timely financial information for day-to-day management and decision making. In the financial management systems area, DOD continues to struggle in its efforts to implement systems to support managerial decision-making. As we recently reported,⁸ DOD can ill afford to invest in systems that are not capable of providing DOD management with more accurate, timely, and reliable information on the results of the department's business operations.

To date, none of the military services or major DOD components has passed the test of an independent financial audit. A continuing inability to capture and report the full cost of its programs represents one of the most significant impediments facing DOD. Nonetheless, the data used to develop the 50-50 report are the only data available and are accepted and used for DOD decision making and for congressional oversight.

Summary of Data in DOD's 50-50 Reports

Table 1 provides a consolidated summary of DOD's 2003 prior-years and future-years reports to the Congress on public and private sector workload allocations for depot maintenance. The amounts shown are DOD's record of actual obligations incurred for depot maintenance work in fiscal years 2001 and 2002 and projected obligations for fiscal years 2003-2007 based on the defense budget and service funding baselines.⁹ The percentages show the relative allocations between the public and private sectors and the exempted workloads. Adding the private and private-exempted percentages together shows what the private-sector amount would have been reported as, absent the recent legislation to exempt qualified partnership workload.

⁸ See U.S. General Accounting Office, *Department of Defense: Status of Financial Management Weaknesses and Progress Toward Reform*, GAO-03-931T (Washington, D.C.: June 25, 2003).

⁹ Although 10 U.S.C. 2466 specifies reporting of funds expended in the prior years and projected to be expended in the future years, DOD's past and current 50-50 reports are based on obligation data. A DOD official explained that obligation data are considered to be more appropriate because of the statutory requirement to report funds made available in a given fiscal year and because expenditure data may not be completely recognized in the accounting records for a year or more following the funds' obligation.

Table 1: DOD Reported Depot Maintenance Funding Allocations

Dollars in millions							
	Prior fiscal years		Future fiscal years				
	2001	2002	2003	2004	2005	2006	2007
Army							
Public	\$1,205	\$1,373	\$1,781	\$1,790	\$1,907	\$2,017	\$2,008
	52.2%	51.5%	55.8%	52.8%	53.6%	52.6%	52.7%
Private	\$1,102	\$1,239	\$1,325	\$1,517	\$1,562	\$1,729	\$1,716
	47.8%	46.5%	41.5%	44.7%	43.9%	45.1%	45.0%
Private exempt ^a	-	\$51	\$84	\$86	\$87	\$87	\$87
		1.9%	2.6%	2.5%	2.4%	2.3%	2.3%
Total	\$2,307	\$2,663	\$3,190	\$3,393	\$3,556	\$3,833	\$3,812
Navy/Marine Corps							
Public	\$4,342	\$5,258	\$4,986	\$4,594	\$5,237	\$5,172	\$5,178
	54.7%	54.5%	54.1%	54.2%	55.2%	55.0%	56.3%
Private	\$3,593	\$4,110	\$4,188	\$3,836	\$4,173	\$4,144	\$3,903
	45.3%	42.6%	45.4%	45.2%	44.0%	44.0%	42.5%
Private exempt ^a	-	\$273	\$46	\$51	\$74	\$94	\$111
		2.8%	0.5%	0.6%	0.8%	1.0%	1.2%
Total	\$7,935	\$9,642	\$9,220	\$8,481	\$9,484	\$9,411	\$9,192
Air Force							
Public	\$3,322	\$4,467	\$4,456	\$4,993	\$5,404	\$5,530	\$5,629
	47.7%	54.1%	51.9%	56.8%	57.9%	56.6%	53.7%
Private	\$3,643	\$3,781	\$4,120	\$3,791	\$3,922	\$4,230	\$4,848
	52.3%	45.8%	48.0%	43.1%	42.0%	43.3%	46.2%
Private exempt ^a	-	\$12	\$9	\$8	\$7	\$7	\$8
		0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Total	\$6,965	\$8,260	\$8,585	\$8,792	\$9,333	\$9,768	\$10,484

Source: DOD's "50-50" Reports, dated Feb. 11 and Apr. 7, 2003.

^aThe provision in 10 U.S.C. 2474 to exempt qualified public-private partnerships from the 50-percent funding limitation began with the 2002 reporting year and is now continued for all contracts entered into through fiscal year 2006. DOD interpreted this to mean that exemptions should also be reported for fiscal year 2007 for contracts initiated in 2002 through 2006.

Weaknesses in Data Preclude Determinations of Compliance in Prior-Years Report

DOD's prior-years report for fiscal years 2001 and 2002 as submitted to the Congress shows the Departments of the Army and Navy to be below the 50-percent funding limitation on private sector workloads for both years. The Air Force reported itself over the limitation in 2001 and below it in 2002. (See table 1.) The net effects of correcting for the errors and omissions we identified would increase the percentages of workload going to the private sector and move each department closer to the contract limit. Appendix I shows the amounts and effects of our adjustments to the reported data submitted by the military departments for fiscal year 2002 and provides a description of the major deficiencies we found. Overall, however, recurring weaknesses in DOD's data gathering, reporting processes, and financial systems prevented us from determining with precision whether the services were in compliance with the 50-50 requirement for fiscal years 2001 and 2002.

Department of the Army

The Army reported its private sector funding to be below the 50-percent limit for both fiscal years 2001 and 2002. Army 50-50 reporting involves multiple commands with somewhat different processes for collecting, summarizing, and validating data. Although the Army utilized a new, more centralized financial system to collect 50-50 data that corrected some of the transcription errors we found last year,¹⁰ we continued to find errors, omissions, and inconsistencies in its data.

For example, as in past years, the Army underreported public and private sector depot-level maintenance work at field locations as it continues unfinished efforts to consolidate maintenance activities and better control the proliferation of depot-level tasks at nondepot locations. Other Army work was not reported because some commands did not receive 50-50 instructions and others misapplied the guidance. Unfamiliarity with the guidance was caused in some instances by the large turnover from last year in the staff responsible for collecting and summarizing data. Staff turnover was cited by each of the military services as contributing to increased errors and training needs. To the extent we identified them, these specific errors would add about \$228 million in total to the Army's public and private sector workloads in 2002; the net effect of correcting for these errors would add 2.5 percent to the private sector percentage allocation in 2002. (See table 2 in app. I.)

¹⁰ GAO-03-16.

Department of the Navy, including the Marine Corps

The Navy reported its private sector funding to be below the 50-percent limit for both fiscal years. Similar to the Army, the Navy's 50-50 process also involves multiple naval commands as well as the Marine Corps. As in prior years, we believe this increases the complexity in managing the process and in ensuring consistency in application of the guidance. It also exacerbates the less than adequate data validation efforts.

We identified several problems that carried over from last year's 50-50 efforts. The Navy did not report any depot maintenance work accomplished along with the nuclear refueling of its aircraft carriers, citing the exclusion of nuclear refueling from the 10 U.S.C. 2460 definition of depot maintenance. We continue to believe that depot repairs not directly associated with refueling tasks should be reported because these kinds of repair actions are reported by other organizations and funding for these tasks are identifiable in contracts and financial systems. The Navy also continues to inconsistently report inactivation activities that involve the servicing and preservation of systems and equipment before it is placed in storage or in an inactive status. Officials report public sector workloads for inactivation activities on nuclear ships but do not report such work on nonnuclear ships, saying that the former workload is complex while the latter is not. We think all such depot-level work should be counted since the statute and implementing guidance does not make a distinction of complexity. These two examples would add about \$401 million to the private sector workloads in fiscal year 2002.

We also determined that about \$41 million of partnership workloads were incorrectly exempted from reporting because the work was not accomplished at a designated depot or was not performed by contract employees.

The Marine Corps data are included as part of the Department of the Navy 50-50 report for compliance purposes, but the Corps exercises a separate process for collecting data. Compared to the other services, the Marine Corps has a small depot program but makes more relative errors and has substantial shortcomings in its management oversight and control actions. For example, most of the program offices in the command that is responsible for acquiring and upgrading weapon systems did not report at all. Our review found that this understated the private sector total for fiscal year 2002 by about \$32 million and the public sector total by almost \$7 million. We also identified other errors including a nearly \$19 million overstatement of the public sector when an official incorrectly included obligations from fiscal year 2001 in the total for 2002.

On balance, for the Department of the Navy as a whole we found the total dollar amount of errors affected the private sector data more than the public sector. Correcting for the errors we found substantially increases the private sector percentage share in fiscal year 2002 from 42.6 percent to 46.9 percent, a gain of over 4 percent. (See table 3 in app. I.)

Department of the Air Force

The Air Force reported that it exceeded the 50-percent funding limitation for the private sector in 2001. As provided by law at the time, the Secretary of the Air Force issued a waiver.¹¹ The Air Force reported itself back below the limitation for fiscal year 2002.

Most of the errors we found were the same or similar from past reviews. For example, the Air Force continues to make a significant adjustment in its reporting for contract administration and oversight costs. The adjustment increases the reported public sector funding and decreases the private sector. The total adjustment was \$125 million (in absolute terms) for fiscal year 2002. Consistent with the 50-50 guidance, which states that costs should be associated with the end product (i.e., the repaired item), we think these costs should instead be treated as contracting expenses. Accordingly, we reversed this adjustment in our analysis. The Air Force also continues to count some component repair costs twice, once when the component is repaired and again when it is installed in an equipment item or assembly during a periodic overhaul. Officials said these are both reportable events, while we think this overstates the amount of actual repair work done. Eliminating the double count would affect about \$666 million in 2002—a \$485 million decrease in the public sector amount and a \$181 million decrease in the private sector.

As in past years, we also identified many errors in the amounts reported for programs supported by interim and contractor logistics support contracts. We determined that several programs used incorrect factors and assumptions to calculate the depot portion of total contract costs. We found other programs that could not adequately explain or justify their estimating methods—some had been developed years ago by officials no longer in the program and simply applied by new staff without checking their validity nor maintaining adequate supporting documentation to explain and rationalize the results. Relatively high turnover of staff

¹¹ The Air Force also reported itself as exceeding the 50-percent limit in fiscal year 2000, and a notice of the waiver was duly issued to the Congress.

responsible for collecting and managing 50-50 data tends to increase the number and persistence of errors and omissions. In total, the net effect of the errors we found would increase the private sector allocation in 2002 by about 2.7 percent. (See table 4 in app. I.)

Future-Year Projections Are Not Reasonable and Not Very Useful

Because of the changing nature of budget projections and supporting data deficiencies, the future-years report does not provide reasonable estimates of public and private sector depot maintenance funding allocations for fiscal years 2003 through 2007. Furthermore, the services tend to place less emphasis and priority on collecting and validating future-years data. The reported projections are based, in part, on incorrect data, questionable assumptions and estimating factors, and some inconsistencies with existing budgets and management plans. As with the prior years, the net effect of the problems we found generally increases the percentage of funding for projected private sector work. The uncertainty and instability of budget estimates combined with the errors and omissions we found result in a future-years report that is not very useful to congressional and DOD decision makers.

We found many of the same problems identified in the prior-years data were continued in the future-years projections. The Army continued to underreport maintenance work at field locations and made other errors similar to its prior-years presentation. While supporting documentation for the Army's projected data was inadequate, errors and omissions of the same magnitude as fiscal year 2002 would add more than \$200 million annually to the totals projected for the public and private sectors in the Army's future-years report. Similarly, in its respective projections, the Navy continued to not report depot maintenance accomplished with, but not directly related to nuclear refueling; the Marine Corps underreported work from the acquisition command; and the Air Force contract estimates again involved some questionable estimating factors and assumptions. Overall, we found this year as in the past that the services tend to place less emphasis and priority on collecting and validating the future-years data compared to efforts on the prior-years data.

Besides errors in reporting, other internal and external factors can create large fluctuations in reported data, which in turn can provide a distorted and misleading view to outside observers about efforts to remain compliant with the 50-50 requirement. For example, in the current future-years report, the Air Force's projected public-sector work financed through the working capital fund is about \$3.0 billion higher than the total amount reported for the same 4-year time period in the future-years report

submitted in 2002. Although this would appear to indicate a large influx of new work to the public depots, in reality the amount of work, according to budget estimates and management reports, is expected to remain fairly level during this reporting period in terms of production hours and size of workforce. Most of the dollar (and percentage) increase in public-sector work is the result of price hikes in the sales rate charged to its customers. Price hikes were caused primarily by increases in the cost of spare and repair parts that were used in the repair process.

The future-year estimates are not reasonable because they represent budget and planning data that change over time, incorporate the same errors found in prior-year data, and also have other problems. The budget and planning data used to project the share of depot maintenance work to be performed in the public and private sectors in the future are estimates. At best, they provide only rough estimates of future funding allocations; and these estimates change over time. As an illustration, our comparison of the consistency of the 2003 reported data with that in DOD's 50-50 reports submitted in 2002 showed that congressional and DOD decision makers were given quite a different view this year of the public-private sector workload mix than that presented just last year. With so many errors and frequent changes, the future-years data may be misleading and not very useful to congressional and DOD decision makers, particularly the further estimates are in the future. While we have identified these shortcomings in the past, the problems continue and show no signs of getting better.

DOD officials agreed that the planning and budget data available for making future projections beyond the budget year are not very useful as predictors of the balance of future workloads between the public and private sectors. They also noted that when the services are within a few percentage points of the 50-50 ceiling, as they are now, the accuracy of the conclusions drawn from the unreliable future projections does not provide a very good basis for forecasting the future.

Opportunities Exist to Improve DOD Reporting

Despite prior improvements, opportunities continue to exist to make 50-50 data a more complete and accurate representation of the balance of funding for depot maintenance work assigned to the public and private sectors. First, streamlining the 50-50 report would offer an opportunity to focus improvement efforts on the data where improvements are most likely to be realized. Second, continued participation of the service audit agencies should improve the quality of the 50-50 data, particularly if the audit support is timely to allow for corrections to be made before the 50-50

report goes to the Congress. Finally, there are opportunities to improve the data development process.

Streamlining the 50-50 Report

As previously discussed, the future-years data—particularly that estimated for the years beyond the current year and budget year—do not provide a reasonable estimate of the future balance of funding for depot maintenance between the public and private sectors. Further, the data may be so bad as to be misleading. Streamlining the data collected to provide data for a shorter period of time could allow responsible officials to focus more closely on the data that are more accurate. Additionally, if the report date to the Congress were extended, the report could be based on more actual costs and require fewer projections, improving the quality of the reported data.

Participation of Service Audit Agencies

While we continue to believe that the service audit agencies could help the military departments improve 50-50 reporting, their future involvement is uncertain. As we have reported in the past, auditor involvement typically identified and corrected substantial errors in the data before the 50-50 reports went to the Congress. However, this year the Air Force Audit Agency did not participate; while the Army did participate, some of the errors they identified were not corrected in the reports to the Congress; and the Navy audit was not done in time to result in changes to the 50-50 data submitted to the Congress. A more meaningful review would be one that was carried on when the data are being aggregated, with input to the process in time to influence the reported data. DOD officials told us that the audit services were not expecting to work on future 50-50 efforts. Audit services are reconsidering their roles because of recent changes to government auditing standards regarding auditor independence when performing both audit and nonaudit management assistance services to the same client.¹²

Air Force auditors have had a positive role in the 50-50 process in past years. Serving in an advisory capacity, they identified errors and cognizant program officials made corrections before the Air Force input was finalized and forwarded to the Office of the Secretary of Defense. This year, however, Air Force auditors decided not to participate. Officials said

¹² See revised standards in U.S. General Accounting Office, *Government Auditing Standards: 2003 Revision*, GAO-03-673G (Washington, D.C.: June 1, 2003).

they were concerned about conflict of interest because auditors participating in the management services review could also be involved in audit service reviews of depot maintenance programs, processes, and funds. While Army auditors participated in the process during this year's cycle and some of their work influenced changes in this year's reported data, some errors were not corrected because of time constraints imposed by the 50-50 reporting schedule. Army officials said the Army Audit Agency would not likely be involved in next year's 50-50 process primarily because of concerns about independence. Navy auditors became involved in the process this year after we recommended their participation in prior reports. However, the Navy Audit Service work was not done in time to influence the Navy's 50-50 report. According to audit service officials, their decision to do an audit of the data after it was submitted rather than providing advisory services to cognizant officials developing the Navy's 50-50 report was influenced by the before-mentioned change in audit standards. Navy program officials said that because a post-process audit did not improve the 50-50 data, the audit service would not be used next year.

We recognize that recent changes in government auditing standards have been made to better address and specify independence issues arising when an audit organization undertakes both audit and nonaudit services for the same client. Nonetheless, the new auditing standards do not preclude auditors from verifying the accuracy of data; providing other technical assistance to the 50-50 process; and accomplishing other audits of the depot maintenance process, programs, and activities. Improved planning, management involvement, and documentation of roles and responsibilities may be required; but a process can be developed to ensure independence will not be compromised. This has already been done so that the service audit agencies can perform similar functions—evaluating validity and consistency of data as it is being developed for subsequent decision making—in support of the base realignment and closure process.

Improving the Data Development Process

Incremental improvements in data development were noticeable in the first several years of 50-50 reporting as guidance was clarified and expanded. However, as we reported last year, the quality of the 50-50 data is not continuing to improve as it did in earlier years of the reporting requirement.¹³ Overall quality and direction of DOD's reporting seems to

¹³ GAO-03-16.

have reached a plateau where further major improvements have been limited. As we have previously discussed, one of the reasons this has occurred is that 50-50 guidance was not always distributed to the people who needed it. Further, significant turnover of personnel responsible for developing the data without providing sufficient time and training to familiarize them regarding the 50-50 requirement and process adversely affected the quality of the 50-50 data. In short, the priority afforded this process by management at all levels in the department is not sufficient to ensure that the data are as accurate as possible.

Conclusions

Continuing errors and omissions in the data for both the prior- and future-years reports indicate that each of the service components is closer to exceeding the limitation on percentage of work permitted to be performed by the private sector than DOD's reporting would indicate. At best, DOD's data over time should be treated as providing a rough approximation of the allocation of depot maintenance workloads between the public and private sectors with some indication of trends. As such, the information on actual prior-years allocations can be useful to the Congress in its oversight role and to DOD officials in deciding support strategies for new systems and in evaluating depot policies and practices. On the other hand, because it provides an increasingly less reliable estimate of projected allocations the further it gets from the current year, the future-years report is not a very useful tool for informing the Congress or DOD officials about likely future compliance. This occurs because of the changing nature of projections, a combination of errors and omissions, less emphasis by the services on the collection and validation of future-years data, and the use of ever-changing budgetary estimates to construct projections. These budgetary estimates—and built-in assumptions—become more inexact and more problematic the further into the future the projections are made due to their very speculative and volatile natures. Indeed, tracking the 50-50 projected data from year to year reveals wide swings in the total amounts reported and in the relative allocations to the public and private sectors. As a result, congressional and DOD decision makers were given quite a different view this year of the public-private sector workload mix than that presented just last year. We believe that these problems are likely to continue and we question the cost-effectiveness of collecting and aggregating data for 3 years past the current and budget years given the problems identified with the estimates.

Furthermore, after the first several years of 50-50 reporting, the overall quality of DOD reporting in terms of accuracy and completeness has not improved significantly. Indeed, the overall quality and direction seem to

have reached a plateau where further major improvements to reporting may be unachievable and where the environmental factors that complicate reporting are not expected to change much. These complicating factors—including a burdensome collection process, tight timeframes for collecting data, high staff turnover, uneven management attention, changing concepts about maintenance organization and delivery—present continued challenges to the services in their ability to make significant improvements to their collection, documentation, and reporting processes. Notwithstanding these constraints, opportunities still exist to improve the reporting, including continued use of the audit services and renewed efforts to ensure guidance is appropriately disseminated and staff trained in its use.

Matter for Congressional Consideration

Given that we continue to see the same problems and complicating factors in our current and past assessments of 50-50 reports and considering that the volatile nature of budget estimates is not likely to change, the Congress should consider amending 10 U.S.C. 2466 to require only one annual 50-50 report. The single report would cover a 3-year period (prior year, current year, and budget year) for which the data are generally more reliable and the potential impacts more immediate. The Congress should also consider extending the due date for the single report from February 1 of each year to April 1; this would provide more time for the military departments to collect and validate data and allow for the incorporation of more actual cost data for the current year estimate.

Recommendations for Executive Action

To enhance data verification and validation, we recommend that the Secretary of Defense require the secretaries of the military departments to direct the use of service audit agencies, or an agreed-upon alternate method, for third-party review and validation of 50-50 data and to ensure that auditor-identified errors in the data are rectified before reports are submitted to the Congress.

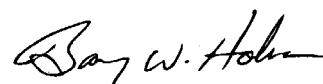
To ensure consistent and complete reporting, we recommend that the Secretary of Defense direct the secretaries of the military departments to ensure that 50-50 reporting guidance is appropriately disseminated to reporting organizations and individuals and that staff are properly and timely trained in the application of the guidance.

Agency Comments and Our Evaluation

In written comments on a draft of this report from the Deputy Under Secretary of Defense for Logistics and Materiel Readiness, DOD concurred with the report's recommendations. However, the department did not agree with limited portions of our analyses regarding some selected workloads and the resulting impacts on the percentage allocation of funds between the public and private sectors. These workloads involve the Navy's nuclear carrier refueling and surface ship inactivation and the Air Force's adjustment for general and administrative expenses and double counting of some reparable workloads. DOD's written comments, and our evaluation of these items in question, are reprinted in appendix III.

We are sending copies of this report to congressional committees; the Secretary of Defense; the Secretaries of the Army, the Navy, and the Air Force; and the Director, Office of Management and Budget. We will make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff has questions regarding this report, please contact me at (202) 512-8412 or holman@gao.gov or Julia Denman, Assistant Director, at (202) 512-4290 or denmanj@gao.gov. Other major contributors to this report were David Epstein, Bruce Fairbairn, Jane Hunt, Larry Junek, Robert Malpass, Andy Marek, Marjorie Pratt, John Strong, and Bobby Worrell.



Barry W. Holman
Director, Defense Capabilities
and Management

Appendix I: GAO Adjustments for Errors, Omissions, and Inconsistencies in Military Departments 50-50 Data for Fiscal Year 2002

Our review of the data supporting the Department of Defense's (DOD) prior-years report identified errors, omissions, and inconsistencies that, if corrected, would revise the total workloads and increase the private-sector allocations for each of the military departments. Brief descriptions of the larger and more extensive problems found follow the adjusted figures.

Department of the Army

Our review of fiscal year 2002 data reported by the Army and of supporting documentation for selected activities identified errors, omissions, and inconsistencies that, if corrected, would result in significant adjustments in the public and private sector percentages reported to the Congress, as shown in table 2.

Table 2: GAO Changes to Army's FY 2002 50-50 Data

Dollars in millions		
Public work reported	\$1,372.6	51.5%
Net adjustments	50.9	
Public work adjusted	\$1,423.5	49.2%
<hr/>		
Private work reported	\$1,238.7	46.5%
Net adjustments	177.0	
Private work adjusted	\$1,415.7	49.0%
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Private work exempted	\$51.4	1.9%
Net adjustments	0	
Exempted adjusted	\$51.4	1.8%

Source: GAO analysis of DOD data.

Errors we found included the following examples:

- Unreported depot-level work associated with the Army's ongoing efforts to consolidate maintenance activities and craft a national maintenance program. Our prior 50-50 reports have documented continuing problems and shortcomings in accurately and consistently reporting depot maintenance accomplished by both public and private sector sources at nondepot locations.

- Unreported one-time repair actions. These are depot repairs that are accomplished at non-depot locations following an organization's request and approval to do this work on a limited basis.
- Unreported work by commands that did not receive Army reporting guidance and other misreported and understated work by some commands that received but misapplied the guidance.
- Other adjustments included (1) errors identified by the Army Audit Agency but not corrected in the data sent to the Office of the Secretary of Defense (OSD) for inclusion in the prior-years 50-50 report to the Congress; and (2) depot support work identified in a contractor's study of the proliferation of depot work at non-depot locations.

Department of the Navy

Our review of fiscal year 2002 data reported by the Navy and Marine Corps and of supporting documentation for selected activities identified errors, omissions, and inconsistencies that, if corrected, would result in significant adjustments in the public and private sector percentages reported to the Congress, as shown table 3.

Table 3: GAO Changes to Navy's and Marine Corps' FY 2002 50-50 Data

Dollars in millions		
Public work reported	\$5,258.1	54.5%
Net adjustments	(115.5)	
Public work adjusted	\$5,142.6	50.8%
<hr/>		
Private work reported	\$4,110.4	42.6%
Net adjustments	640.9	
Private work adjusted	\$4,751.3	46.9%
<hr/>		
Private work exempted	\$273.1	2.8%
Net adjustments	(40.7)	
Exempted adjusted	\$232.4	2.3%

Source: GAO analysis of DOD data.

Note: Numbers in parentheses are negative.

Errors we found included the following examples:

- Unreported depot work on nuclear aircraft carriers. As reported last year, Navy officials cite the definition in 10 U.S.C. 2460, which excludes from depot maintenance the nuclear refueling of aircraft carriers, in justifying why they do not report any of the depot work accomplished at the same time as refueling. We believe that depot work that is reportable elsewhere and separate from the refueling tasks should be reported.
- Inconsistent reporting of ship inactivations, which include depot tasks for servicing and preserving equipment before they are placed in storage or in an inactive status. Navy officials report for 50-50 purposes the nuclear ship inactivation work performed in the public sector but do not report surface ship inactivation work performed by the private sector.
- Underreporting of maintenance work by the command responsible for acquiring and upgrading Marine Corps weapon systems. Failure to report has several causes, including misunderstanding of what should be reported, limited dissemination of the 50-50 guidance, and inadequate management and oversight of the collection process to identify and resolve reporting deficiencies.
- Incorrectly exempting some private-sector activities from reporting. The Navy exempted more work than did the other departments; but we found some in error, including partnering work accomplished at a contractor facility and some work actually performed by government employees. Partnership work qualifying for the exemption must be accomplished at designated public depots by contractor employees.
- Other errors included (1) work subcontracted by the public shipyards to the private sector reported as public sector work and (2) misreporting by the Marine Corps of work obligated in fiscal year 2001 rather than 2002.

Department of the Air Force

Our review of fiscal year 2002 data reported by the Air Force and of supporting documentation for selected activities identified errors, omissions, and inconsistencies that, if corrected, would result in significant adjustments in the public and private sector percentages reported to the Congress, as shown in table 4.

Table 4: GAO Changes to Air Force's FY 2002 50-50 Data

Dollars in millions		
Public work reported	\$4,467.0	54.1%
Net adjustments	(547.9)	
Public work adjusted	\$3,919.1	51.4%
Private work reported	\$3,781.4	45.8%
Net adjustments	(82.5)	
Private work adjusted	\$3,698.9	48.5%
Private work exempted	\$11.9	0.1%
Net adjustments	0	
Exempted adjusted	\$11.9	0.2%

Source: GAO analysis of DOD data.

Note: Numbers in parentheses are negative.

Errors we found included the following examples:

- As in past years, Air Force officials continue to adjust the 50-50 data for the salaries and overhead expenses of government employees administering depot maintenance contracts funded through the working capital fund. Officials subtract these amounts from the reported private sector amount—where they are accounted for within the working capital fund—and add them to the public sector funding for 50-50 reporting. Consistent with the 50-50 guidance that states that costs should be associated with the end product, we think these costs should be treated as contracting expenses.
- Our review of Air Force workloads determined that funding for some component repairs was counted twice in 50-50 data, once when the item was repaired and the second time when it was installed into a weapon system or major subsystem during its overhaul. This resulted in overstating both public sector work and, by a lesser amount, private sector work.
- Errors occurred in reporting depot costs on interim contractor support and contractor logistics support contracts. Our review of selected programs identified numerous errors resulting in net underreporting of depot maintenance work performed by contractors. Many problems resulted from questionable factors and assumptions used in developing

estimating methodologies. Because interim contractor support and contractor logistics support contracts often cover more than just depot maintenance (including lower levels of maintenance, supply operations, and logistics program management), the OSD guidance allows for the use of estimating methods. This can cause complications and introduce subjectivity into the data collection process. Newer contract approaches under acquisition reform efforts pose particularly challenging problems in identifying the depot portion.

Examples of errors and questionable practices we found included

- not updating a methodology when contract provisions and circumstances change, resulting in not reporting additional maintenance work from increased operational contingencies and new orders of materials;
- assuming a straight percentage of total cost as depot work where data exists to make a more exact accounting;
- not reporting maintenance on a newly acquired modification; and
- not reporting software depot maintenance.

Appendix II: Scope and Methodology

To determine whether the military departments met the 50-50 requirement in the prior-years report, we analyzed each service's procedures and internal management controls for collecting and reporting depot maintenance information for purposes of responding to the section 2466 requirement. We reviewed supporting details (summary records, accounting reports, budget submissions, and contract documents) at departmental headquarters, major commands, and selected maintenance activities. We compared processes to determine consistency and compliance with legislative provisions, OSD guidance, and military service instructions. We selected certain programs and maintenance activities for a more detailed review.¹ We particularly examined reporting categories that DOD personnel and we had identified as problem areas in current and past reviews. These areas included interserviced workloads,² contractor logistics support, warranties, software maintenance, and depot maintenance at nondepot locations. We evaluated processes for collecting and aggregating data to ensure accurate and complete reporting and to identify errors, omissions, and inconsistencies. We coordinated our work, shared information, and obtained results of the Army and Air Force service audit agencies' data validation efforts.

To determine whether the future-year projections were based on accurate data, valid assumptions, and existing plans and represented reasonable estimates, we followed the same general approach and methodology used to review the prior-years report. Although the future-years report is a budget-based projection of obligations, the definitions, guidance, organization, and processes used to report future data are much the same as for the prior-years report of actual obligations. We discussed with DOD officials the main differences between the two processes and the manner in which the data were derived from budgets and planning requirements and key assumptions made in the outyear data.

For reviews of both 50-50 reports, we performed certain checks and tests, including variance analyses, to judge the consistency of this information with data from prior years and with the future-years budgeting and

¹ We selected the programs reviewed based on size and importance, leads obtained from internal auditors, and any previously identified areas of concern. Given the nature of our sample, the results are not projectable to the universe of depot maintenance activities. We also did not audit the integrity of DOD's financial systems and accounting data used to prepare the 50-50 reports.

² Interserviced workload is maintenance that one military service performs on equipment owned and funded by another service.

programming data used in DOD's budget submissions and reports to the Congress. For example, we compared each service's 50-50 data reported in February and April 2003 for the period 2001 through 2006 with data reported for these same years in the 50-50 reports submitted in 2002. We found repeated and significant changes, even though the estimates were prepared only about 1 year apart. We used this analysis to further discuss with officials and analyze reasons for changes in reported data and percentage allocations between the 2002 and 2003 reports submitted to the Congress. Variance analysis showed that congressional and DOD decision makers were given quite a different view of the public-private sector workload mix than that presented just last year.

Several factors concerning data validity and completeness were considered in our methodology and approach to reviewing the prior- and future-years reports. One key factor is the continuing deficiencies we have noted in DOD's financial systems and reports that preclude a clean opinion on its financial statements and that result in limited accuracy of budget and cost information. Another factor is that documenting depot maintenance workload allocations between the public and private sectors is becoming more complicated by the consolidation of maintenance activities and the performance of depot-level maintenance at field locations. These complicating factors (1) make it more difficult to identify work that meets the statutory definition of depot maintenance, (2) complicate workload reporting, and (3) result in underreporting of depot maintenance for both the public and private sectors. In addition, changes in business philosophy and approach can make analysis more difficult. For example, many new contracts are performance-based and may not discretely identify maintenance activities or account separately for their costs. This can result in under- and overreporting of depot maintenance work performed in the private sector. It also forces more reliance on the contractor for providing information needed in 50-50 reporting and may result in DOD officials having to use more assumptions and estimating methodologies in lieu of contract data.

As part of our efforts to identify areas for improvement, we reviewed DOD's efforts to improve the accuracy and completeness of reports. We discussed with officials managing and coordinating the reporting process their efforts to address known problem areas and respond to recommendations by the audit agencies and us. We compared this year's sets of instructions with last year's to identify changes and additions. We reviewed efforts to identify reporting sources and to distribute guidance and taskings. We asked primary data collectors to provide their opinions on how well efforts were managed and data verified and to identify "pain

points" and ideas they had to improve reporting. We reviewed prior recommendations and service audit agency findings to determine whether known problem areas were being addressed and resolved. We applied this knowledge to identify additional areas for improving the reporting process and management controls.

We interviewed officials, examined documents, and obtained data at OSD, Army, Navy, Marine Corps, and Air Force headquarters in the Washington, D.C., area; Army Materiel Command in Alexandria, Virginia; Naval Sea Systems Command in Washington, D.C.; Naval Air Systems Command in Patuxent River, Maryland; Marine Corps Materiel Command in Albany, Georgia; Air Force Materiel Command in Dayton, Ohio; Army Audit Agency in Washington, D.C.; Naval Audit Service in Crystal City, Virginia; several public depots managed by the military departments' materiel commands; and selected operating bases. We conducted our review from February to July 2003 in accordance with generally accepted government auditing standards.

Appendix III: Comments from the Department of Defense

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

<p>DEPARTMENT OF DEFENSE UNITED STATES OF AMERICA</p> <p>DEPUTY UNDER SECRETARY OF DEFENSE FOR LOGISTICS AND MATERIEL READINESS 3500 DEFENSE PENTAGON WASHINGTON, DC 20301-3500</p> <p>August 26, 2003</p> <p>Mr. Barry W. Holman Director, Defense Capabilities and Management U.S. General Accounting Office 441 G Street, N.W. Washington, DC 20548</p> <p>Dear Mr. Holman:</p> <p>This is the Department of Defense (DoD) response to the GAO draft report, "DEPOT MAINTENANCE: 50-50 Reporting Should Be Streamlined," dated July 25, 2003 (GAO Code 350315/GAO-03-1023).</p> <p>The Department concurs with recommendations 1 and 2. Detailed comments on the GAO recommendations and report are enclosed.</p> <p>Sincerely,</p> <p><i>Diane K. Morales</i> Diane K. Morales</p> <p>Enclosure: As stated</p> <p style="text-align: center;">GAO-03-1023 Depot Maintenance</p>

**GAO DRAFT REPORT – DATED JULY 25, 2003
GAO CODE 350315/GAO-03-1023**

“DEPOT MAINTENANCE: 50-50 Reporting Should Be Streamlined”

**DEPARTMENT OF DEFENSE COMMENTS
TO THE RECOMMENDATIONS**

Report language
is now on p. 18.

RECOMMENDATION 1: To enhance data verification and validation, the GAO recommended that the Secretary of Defense require the Secretaries of the Military Departments to direct the use of Service audit agencies, or an agreed-upon alternate method, for third-party review and validation of 50-50 data to ensure that auditor-identified errors in the data are rectified before reports are submitted to the Congress. (p. 21/GAO Draft Report)

DOD RESPONSE: Concur. The Department agrees that past efforts utilizing third-party review within the military departments to validate data prior to submission of the report to Congress have decreased errors and that the recommendation should be implemented.

RECOMMENDATION 2: To ensure consistent and complete reporting, the GAO recommended that the Secretary of Defense direct the Secretaries of the Military Departments to ensure that 50-50 reporting guidance is appropriately disseminated to reporting organizations and individuals and that staff are properly and timely trained in the application of the guidance. (p. 22/GAO Draft Report)

DOD RESPONSE: Concur. The Department will reinforce this existing policy during future reporting cycles.

Report language is
now on p. 17.

Report language is
now on p. 21. See
also p. 10.

See comment 1.

See comment 2.

COMMENTS ON THE REPORT

1. Page 21. “... the Congress should consider amending 10 U.S.C. 2466 to require only one annual 50-50 report. The single report would cover a 3-year period (prior year, current year and budget year) for which the data are generally more reliable and the potential impacts more immediate. The Congress should also consider extending the due date for the single report from February 1 of each year to April 1; this would provide more time for the military departments to collect and validate data and allow for the incorporation of more actual cost data for the current year estimate.”

Comment: The Department agrees with this GAO “Matter for Congressional Consideration” which is fully consistent with the Department’s initiative on congressional reports reduction and simplification.

2. Page 25, Table 3. The Department does not agree with the two GAO adjustments for nuclear aircraft carriers and surface ship inactivations. The \$401 million in adjustments for nuclear aircraft carriers and surface ship inactivations should be removed from Table 3, resulting in a net adjustment of \$239.9 million in private work reported for the Navy.

a. The Navy has always interpreted 10 U.S.C. 2460 to broadly exclude from the 10 U.S.C. 2466 reporting limitation all work associated with the Refueling Complex Overhaul (RCOH) of a nuclear aircraft carrier. Although 10 U.S.C. 2460 contains the term “nuclear refueling of an aircraft carrier” to describe the 50-50 exclusion, the Navy considers this to be an abbreviated substitute for the standard terminology “Refueling Complex Overhaul (RCOH)” of a nuclear aircraft carrier. GAO states non-nuclear depot repairs are “severable” tasks identifiable in contracts and financial systems (page 11). The Department does not agree with GAO, because these tasks are not “severable” from an RCOH contract. The Navy would never arbitrarily split the scope of work for an RCOH into nuclear and non-nuclear portions, with the nuclear work being accomplished in the private sector, and the non-nuclear work being accomplished in the public sector. This approach would be extremely inefficient, costly, and problematic to manage. Instead, the Navy awards a single contract for RCOH work to the private sector, the only certified depot source of repair.

b. The Department considers the relatively complex process of nuclear ship inactivation workload to be equivalent to depot level maintenance and repair. It does not consider conventional ship inactivation workload performed in the private sector to be equivalent to depot level maintenance and repair. Also, work is accomplished either by the ship’s force or by the NAVSEA Inactive Ship Maintenance Offices at Pearl Harbor, HI, Bremerton, WA, and Philadelphia, PA. Neither the private sector nor the public sector conventional inactivation work is reported.

**Appendix III: Comments from the Department
of Defense**

Report language is now
on p. 23. See also p. 11.

See comment 3.

Report language is now
on p. 23. See also p. 11.

See comment 4.

3. Page 27. "As in past years, Air Force officials continue to adjust the 50-50 data for the salaries and overhead expenses of government employees administering depot maintenance contracts funded through the working capital fund. Officials subtract these amounts from the reported private sector amount – where they are accounted for within the working capital fund – and add them to the public sector funding for 50-50 reporting. Consistent with the 50-50 guidance that states these costs should be associated with the end product, we think these costs should be treated as contracting expenses."

Comment: The Air Force consistently reports costs for government personnel managing depot maintenance contracts as part of the public sector. Counting these costs as contract would misrepresent the percentages of funds expended for work by DoD versus non-government employees. However, the Air Force expanded guidance on the General and Administrative (G&A) adjustment in Air Force procedures. The adjustment represents the Federal employee resources required for managing the contract depot maintenance administrative requirements.

4. Page 27. "Our review of Air Force workloads determined that funding for some component repairs was counted twice in 50-50 data, once when the item was repaired and the second time when it was installed into a weapon system or major subsystem during its overhaul. This resulted in overstating both public sector work and, by a lesser amount, private sector work."

Comment: The Department does not agree that the treatment of component repair costs, when repaired items are used in higher level assemblies, is inconsistent with statutory requirements. The repair of exchangeables and the use of exchangeables during system and subsystem overhaul and repair are two distinct and separate transactions. Both transactions are depot-level maintenance events that must be reported in accordance with the requirements of 10 U.S.C. 2466(e), based on application of the definition contained in 10 U.S.C. 2460.

The following are GAO's comments on the Department of Defense's letter dated August 26, 2003.

GAO Comments

1. The department did not agree with our adjustment for nuclear aircraft carriers. The Navy interprets the 10 U.S.C. 2460 exclusion of nuclear refueling of aircraft carriers from the definition of depot maintenance to mean that no work associated with the refueling complex overhaul of nuclear carriers is reportable for 50-50 purposes. Navy officials also said that non-nuclear depot repairs on carriers are not severable tasks to be split out from contracts. We continue to believe that the costs of depot repairs and tasks not directly associated with nuclear refueling tasks during carrier overhauls should be reported. Many maintenance tasks performed at the same time as the nuclear refueling are not related to the refueling; and when these and similar tasks are performed during other maintenance activities, the Navy does report them as depot maintenance. We found that the funding for these tasks is clearly identifiable in the contract financial records and could be counted just like other 50-50 work. In our view, without some nexus between that work and refueling work, it would be inconsistent with the plain language of section 2460 to exempt that work simply because it was performed during a refueling complex overhaul of nuclear carriers. We deleted the reference to severable tasks in the body of the report, as our intent was not to suggest that the Navy break out non-nuclear work from nuclear work onto separate contracts or work orders, but rather that the funding for non-nuclear refueling work accomplished on existing contracts be identified and reported.
2. The department did not agree with our adjustment for surface ship inactivations. DOD considers nuclear ship inactivation work to be a relatively complex process that is equivalent to depot level maintenance, but that conventional ship inactivation work performed by the private sector is not as complex and is not equivalent to depot-level maintenance. In addition, the department's written response indicated that surface ship inactivation work accomplished by the public sector is also not reported in the 50-50 data. We believe that inactivation work should be reported because the relevant title 10 statutes and OSD's 50-50 guidance do not make this distinction of relative complexity and requires reporting of all depot maintenance, regardless of location and source of funding. Further, DOD's Financial Management Regulation 7000.14-R, vol. 6A, ch. 14 (which prescribes depot maintenance reporting requirements) includes inactivation as a depot maintenance activity. Although we did not review inactivation

work accomplished by public sector workers, it should also be reported if it meets the definition of depot maintenance.

3. The Air Force did not agree with our reversal of the 50-50 reporting adjustment it makes for the salaries and overhead expenses of government employees administering depot maintenance contracts. The Air Force believes that the costs for government personnel managing depot maintenance contracts represent public sector costs; therefore, to report them as contract would misrepresent the public-private sector percentage allocations. However, OSD's 50-50 guidance requires that all the costs associated with accomplishing a specific depot workload—labor, material, parts, indirect, and overhead—should be counted for 50-50 purposes in the sector accomplishing the actual maintenance. The guidance cites examples, such as counting the contract maintenance on depot plant equipment as public sector costs because the plant equipment is part of the costs incurred to perform maintenance at the depot. Similarly, we think that contract administrative costs should be counted as part of the costs incurred to accomplish the work in the private sector. We note that the Air Force will stop making this adjustment after this year when financing for the depot contracts is moved from the working capital fund to direct appropriations. It remains to be seen, however, how the Air Force will account for contract administrative expenses in the future.
4. The department did not agree that counting the repair costs twice for some components installed in higher level assemblies is inconsistent with the statutory requirements of 10 U.S.C. 2466(e) and 10 U.S.C. 2460. The Air Force believes that the original repair cost for a component and its subsequent cost as material used in system or subsystem overhaul are two distinct and separate transactions and that both costs should be reported for 50-50 purposes. We continue to believe that counting some component repair costs twice when the components are incorporated in a higher-level assembly distorts the 50-50 reports and the actual amount of work accomplished by both the public and private sectors. In our view, there is no reason to conclude that the intent of title 10 requires double counting component repairs and that a more reasonable reading is that DOD can implement those provisions so as to allow for adjustments in reporting to more accurately reflect the cost of depot work. DOD adopted a similar approach in response to a recommendation in our 2001 report.¹ In that

¹ GAO-02-95.

report, we found that unrealistic and outdated budget data were being reported when there were other, more accurate information sources. Accordingly, OSD revised its 50-50 guidance to allow for revising budgetary estimates to better reflect known and anticipated changes in workloads, workforce, priorities, and performance execution rates. This resulted in the Air Force reporting additional hundreds of millions of dollars in projected depot work based on current workload estimates. A similar approach could be used to eliminate the effects of double counting reparables later used in higher-level assemblies.

Related GAO Products

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