



November 2019

DEFENSE MANAGEMENT

Defense-Wide
Working Capital Fund
Agencies Apply Most
Key Operating
Principles but Should
Improve Pricing
Transparency

Accessible Version

GAO Highlights

Highlights of [GAO-20-65](#), a report to the Senate Armed Services Committee

Why GAO Did This Study

As DOD continues to focus its resources on improving military readiness and modernizing its forces, it seeks to minimize costs associated with its business operations. DFAS, DISA, and DLA are financed through the Defense-Wide Working Capital Fund (DWWCF). Collectively, they provide shared services and goods to their customers, including finance and accounting services; information technology services; and fuel provision and inventory management.

Senate Report 115-262, accompanying a bill for the National Defense Authorization Act for Fiscal Year 2019, includes a provision that GAO evaluate the activities DWWCF agencies fund through overhead charges and fees collected from customers. This report evaluates the extent to which DFAS, DISA, and DLA (1) have a process for setting rates to recover costs and provide transparent pricing to customers and (2) clearly delineate roles and responsibilities, measure performance, and assess resource requirements and customer needs. GAO reviewed relevant sections of DOD's *Financial Management Regulation* and agency documentation and interviewed officials from DFAS, DISA, and DLA and the military departments in comparing the agencies' management practices to the key operating principles for effective management of working capital funds.

What GAO Recommends

GAO recommends that DFAS, DISA, and DLA provide more complete information to customers on their rate-setting methodologies. DOD concurred with GAO's recommendations.

View [GAO-20-65](#). For more information, contact Elizabeth A. Field at (202) 512-2775 or field1@gao.gov.

November 2019

DEFENSE MANAGEMENT

Defense-Wide Working Capital Fund Agencies Apply Most Key Operating Principles but Should Improve Pricing Transparency

What GAO Found

The Defense Finance and Accounting Service (DFAS), Defense Information Systems Agency (DISA), and Defense Logistics Agency (DLA) use a combination of approaches to set rates that are intended to recover their costs and equitably allocate costs to customers. However, DFAS, DISA, and DLA have not provided transparent pricing to the military departments, which are their largest customers. Each agency annually develops budget proposals designed to recover projected costs and account for gains or losses from prior years. DFAS, DISA, and DLA have taken steps intended to establish an equitable pricing methodology. For example, DLA changed its pricing method for distribution services to align the rates customers pay with DLA's costs of providing the service. However, customers from the military departments said they lack visibility into the factors that determine their overall costs at one or more of the three defense agencies, including how indirect costs are allocated and included in the rates they are charged. GAO's review of cost and rate documentation provided to the military departments also found that they provide high-level information, such as the rates and estimated workloads, and did not include details about the types of costs included or how they are calculated. Specifically,

- DFAS informational briefings do not describe the types of costs included in rates and how those costs are calculated and allocated. As a result, customers from the Army and Navy said they were confused about why declines in their use of DFAS's services have not resulted in reduced costs.
- DISA does not include in its documentation the methodology it uses to calculate its rates, making it difficult for officials from the Air Force to determine how they can manage their costs with DISA.
- DLA does not provide detailed information on the costs included in its rates, making it difficult for customers from the Navy and Air Force to determine how to lower their costs or, in the case of the Air Force, understand the cost implications of DLA's newly announced pricing initiative.

Because DFAS, DISA, and DLA share only high-level information on their rate-setting methodologies, the military departments have been limited in their abilities to understand and manage the costs they pay for the services they obtain. By providing more complete information on rate setting, including the calculation and use of costs, DFAS, DISA, and DLA could help their customers better manage their costs and make more informed budgeting decisions. Improved transparency could also help customers anticipate how potential changes to the assumptions underlying rates could affect future costs.

GAO also found that DFAS, DISA, and DLA clearly delineate roles and responsibilities, measure performance, and assess resource requirements and customer needs for goods and services, as called for by the three remaining key operating principles for effective working capital fund management. As a result, these agencies are positioned to promote a clear understanding of who will be held accountable for specific tasks or duties, reduce the risk of mismanaged funds, measure their operational performance and identify opportunities to improve performance, and use resources most effectively.

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Abbreviations

| | |
|------|--|
| DFAS | Defense Finance and Accounting Service |
| DISA | Defense Information Systems Agency |
| DLA | Defense Logistics Agency |
| DOD | Department of Defense |

DWWCF Defense-Wide Working Capital Fund

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November 1, 2019

The Honorable James M. Inhofe
Chairman
The Honorable Jack Reed
Ranking Member
Committee on Armed Services
United States Senate

As the Department of Defense (DOD) continues to focus resources on improving military readiness and modernizing its force, it seeks to minimize costs associated with its business operations. One way to do this is to consolidate into a single shared provider those services that are used by multiple defense organizations to improve efficiency and reduce costs. The provision of shared services may be funded through direct appropriations or through an intragovernmental revolving fund, such as a working capital fund. Working capital funds operate as a self-supporting entity that conducts a regular cycle of businesslike activities, and they are intended to create incentives for customers and managers to control costs.

To control and account more effectively for the cost of programs and work performed, the Secretary of Defense may establish working capital funds to finance inventories of designated supplies and provide working capital for industrial- and commercial-type activities that provide common services within or among DOD components.¹ The Defense-Wide Working Capital Fund (DWWCF) satisfies recurring requirements for finance and accounting services, management of parts and supplies, inventory and fuel provision, information technology services, and other services needed by DOD organizations.² The DWWCF finances the activities of the Defense Finance and Accounting Service (DFAS), the Defense Information Systems Agency (DISA), and the Defense Logistics Agency (DLA) (hereafter referred to collectively as the DWWCF agencies), which provide goods and services to customers that include the military

¹10 U.S.C. § 2208.

²DOD has established five separate working capital funds—Army, Navy, Air Force, Defense-Wide, and Defense Commissary Agency. In this report, we are focusing on the Defense-Wide Working Capital Fund.

departments, defense agencies and organizations, and non-DOD federal agencies, among others. These three DWWCF agencies set rates to cover costs associated with providing goods and services, which include costs associated with materials, overhead, and operations. Customers have raised questions about the transparency of costs charged by the DWWCF agencies.

Senate Report 115-262 accompanying a bill for the National Defense Authorization Act for Fiscal Year 2019 contained a provision that we evaluate the activities DWWCF agencies fund through overhead charges and fees collected from customers.³ In this report, we evaluate the extent to which the defense agencies (1) have a process for setting rates to recover costs and provide transparent pricing to customers and (2) clearly delineate roles and responsibilities, measure performance, and assess resource requirements and customer needs.

For our first objective, we reviewed sections of DOD 7000.14-R, *Financial Management Regulation*, specific to working capital funds as well as the processes that DFAS, DISA, and DLA use to set rates for products and services.⁴ We met with officials from these DWWCF agencies and the Office of the Under Secretary of Defense (Comptroller) and obtained documentation outlining the agencies' rate-setting methodologies and the types of costs that each agency charges to customers. We also met with officials from six offices within the three military departments to obtain the perspectives of the military departments as the three largest customers of the DWWCF agencies. We talked with officials from the following offices: Army Budget Office; Deputy Assistant Secretary of the Army (Financial Operations); the Navy's Deputy Assistant Secretaries for Budget and for Financial Policy and Systems; the Air Force's Deputy Assistant Secretary for Budget; and the Air Force's Office of Information Dominance and Chief Information Officer.

We used this information to evaluate the rate-setting process for all three DWWCF agencies against the principle of working capital fund self-sufficiency, one of four key operating principles for effective working

³S. Rep. No. 115-262, at 144 (2018).

⁴During the course of our audit, we relied on the April 2013 version of DOD 7000.14-R *Financial Management Regulation*, vol. 11B, chap. 1, *Defense Working Capital Funds General Policies*. Volume 11B, chapter 1 was subsequently revised in August 2019. The revisions did not affect our findings or recommendations.

capital fund management identified by us in a prior report.⁵ Each of the four key operating principles has three underlying components describing specific actions agencies should take to adhere to the principle. Our analysis focused on comparing the rate-setting processes of the three DWWCF agencies against the key operating principle of self-sufficiency rather than on assessing the results of those processes. Therefore, although the components of this principle include the recovery of actual costs and transparent and equitable pricing, we did not independently verify whether the processes resulted in the recovery of actual costs or in the equitable allocation of costs among customers.

For our second objective, we obtained documentation from DFAS, DISA, and DLA on their management practices and discussed the information with knowledgeable agency officials and, where customers' perspectives were needed, officials from the same offices in the military departments we met with for our first objective. We evaluated the DWWCF agencies' management practices related to the delineation of roles and responsibilities, performance measurement, and communication with customers against the other three key operating principles for effectively managed working capital funds identified in our prior report, which are described later in this report and in more detail in appendix I.⁶ We assessed the extent to which these agencies followed each key operating principle and their associated components.

We conducted this performance audit from September 2018 through November 2019 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁵GAO, *Intergovernmental Revolving Funds: Commerce Departmental and Census Working Capital Funds Should Better Reflect Key Operating Principles*, [GAO-12-56](#) (Washington, D.C.: Nov. 18, 2011). To identify the four key operating principles, GAO reviewed government-wide guidance on business operating principles, internal controls, managerial cost accounting and performance management, agency-specific guidance, and prior GAO work. GAO also met with officials from the Office of Management and Budget and other agencies.

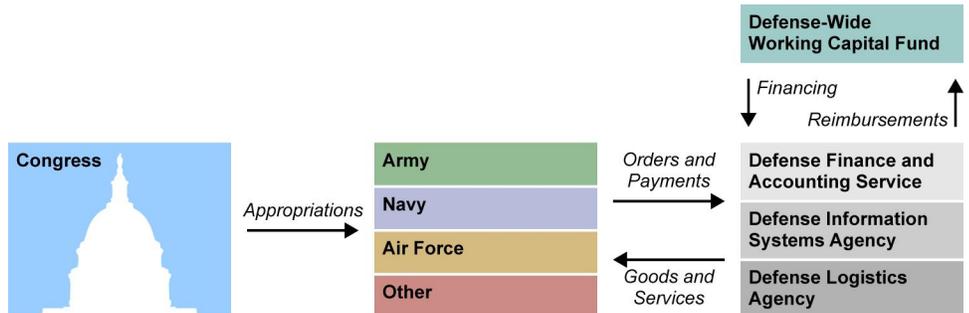
⁶[GAO-12-56](#).

Background

Overview of DWWCF Operations

Like all DOD working capital funds, the DWWCF received its initial working capital through an appropriation or a transfer of amounts from existing appropriations to finance the initial cost of products or services. Ongoing DWWCF operations and maintenance of a minimum cash balance are funded through reimbursements to the DWWCF comprised of customer payments made to DFAS, DISA, and DLA. The flow of funding and provision of goods and services between the DWWCF agencies, their customers, and the DWWCF is shown in figure 1.

Figure 1: Overview of Defense-Wide Working Capital Fund Operations



Source: GAO analysis of Department of Defense (DOD) information. | GAO-20-65

DFAS, DISA, and DLA use funds from the DWWCF to provide goods and services across six activity groups, as shown in table 1.⁷ Activities of the DWWCF agencies operate on a break-even basis. As part of the annual budget submission for each upcoming fiscal year, rates are required to be established at levels estimated to recover the budgeted costs of goods and services, including all general and administrative overhead costs, prior period gains and losses, and applicable surcharges. Predetermined or “stabilized” rates developed during the budget process are applied to orders received from DWWCF customers during the fiscal year. The Office of the Under Secretary of Defense (Comptroller) is responsible for reviewing, coordinating, and publishing reimbursable rates for DOD. Where feasible, the Office of the Under Secretary of Defense

⁷Activity groups are categories within the DWWCF that identify the types of goods and services financed using the fund. Each activity group is managed by one defense agency.

(Comptroller) publishes applicable reimbursable rates prior to the beginning of each new fiscal year.

Table 1: Defense Agencies Financed through the Defense-Wide Working Capital Fund (DWWCF), Services Provided, and Activity Groups

| Agency | Services provided | Activity group |
|--|--|---|
| Defense Finance and Accounting Service | Centralized finance, accounting, human resources, and financial systems management services through a single activity group. | 1. Finance and Accounting Services |
| Defense Information Systems Agency | Information technology and contracting services. | 2. Computing Services 3. Telecommunications Services and Enterprise Acquisition Services |
| Defense Logistics Agency | Fuel, consumable supplies and parts, and document services. | 4. Energy Management 5. Supply Chain Management 6. Document Services |

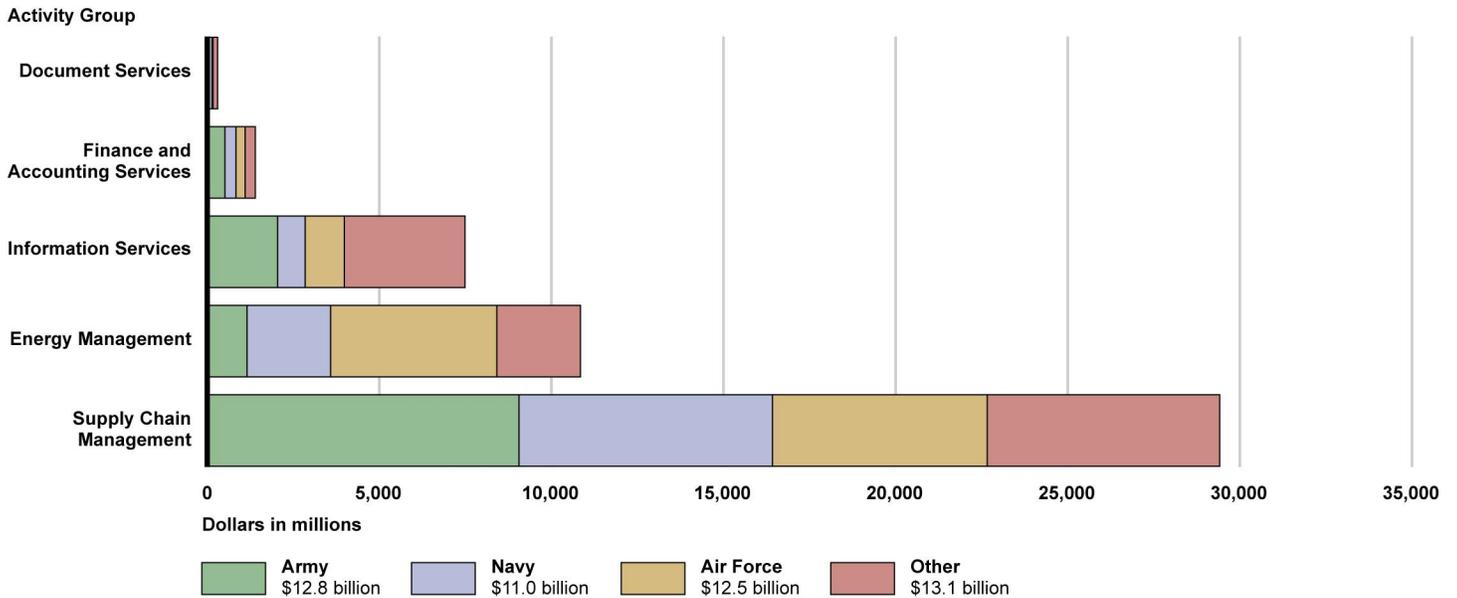
Source: GAO Analysis of Department of Defense (DOD) information. | GAO-20-65

Note: In its fiscal year 2020 budget justification, DOD stated that, going forward, DISA's two activity groups would be presented in budget materials as a single activity group called the Information Services Activity Group.

The military departments are the primary consumers of goods and services provided by the DWWCF agencies. In fiscal year 2018, the reported total dollar value of goods and services ordered from DFAS, DISA, and DLA was approximately \$49.4 billion, with the military departments collectively ordering about \$36.3 billion (or 74 percent of the total dollar value of orders in fiscal year 2018) in goods and services.⁸ Most of the goods and services they purchased fell under two activity groups—supply chain management and energy management. Specifically, approximately \$29.4 billion (60 percent of the total dollar value of orders in fiscal year 2018) were for supply chain management and approximately \$10.8 billion (22 percent of the total dollar value of orders in fiscal year 2018) were for energy management, as shown in figure 2.

⁸In addition to the military departments, DWWCF customers include other DOD and non-DOD agencies and foreign countries, among others, that collectively ordered about \$13.1 billion in goods and services in fiscal year 2018.

Figure 2: Breakdown of Fiscal Year 2018 Orders of Goods and Services by Defense-Wide Working Capital Fund Activity Group and Customer



Source: GAO analysis of Department of Defense (DOD) budget data. | GAO-20-65

Notes: The Defense Finance and Accounting Service (DFAS) provides finance and accounting services; the Defense Information Systems Agency (DISA) provides computing services and telecommunications and enterprise acquisition services; and the Defense Logistics Agency (DLA) provides document services, energy management, and supply chain management. The Department of the Navy figures combine both the Navy and Marine Corps orders. Other customers include DOD and non-DOD agencies and foreign countries, among others. The numbers for each military department and other customers reflect the reported total dollar value of goods and services ordered from DFAS, DISA, and DLA in fiscal year 2018.

Operating Budgets and Cash Balance Requirements for DWWCF Activities

Prior to the beginning of the fiscal year, Annual Operating Budgets are issued for each DWWCF activity group managed by DFAS, DISA, and DLA. Budget formulation for a particular fiscal year begins approximately 18 months prior to the beginning of that fiscal year. Each activity’s Annual Operating Budget identifies total budgetary resources authorized for use during the fiscal year.⁹ In addition, each DWWCF agency is responsible for maintaining positive cash balances sufficient to allow their operations

⁹Total budgetary resources is the sum of estimated reimbursements expected to be earned during the fiscal year, plus contract authority and recoveries of prior year unpaid obligations.

to continue uninterrupted. As of the end of fiscal year 2017, the DWWCF as a whole held a reported cash balance of about \$3.0 billion, which decreased to \$2.6 billion by the end of fiscal year 2018. According to DWWCF agency officials, it can be challenging to maintain an appropriate cash balance within the DWWCF because setting accurate rates that reflect their agencies' actual costs is difficult. If rates are set too low during the budget formulation process, higher-than-expected costs or lower-than-expected sales of goods or services during the fiscal year may result in losses for the DWWCF, which in turn may lead to insufficient balances to meet the minimum current or future financing operational requirements.¹⁰ Similarly, if rates are set too high, lower-than-expected costs or higher-than-expected customer sales during the fiscal year may generate excessive gains for the DWWCF. Excessive gains may be transferred out of the DWWCF into other appropriation accounts or rescinded by Congress.¹¹

In 2017, we described the DWWCF's reported monthly cash balances and the extent to which they fell within targeted upper and lower cash requirements.¹² We found that the DWWCF's reported monthly cash balances were outside the targeted upper and lower cash requirements for 87 of 120 months during that time frame. This was caused by DLA charging its customers more or less than it cost to purchase, refine, transport, and store fuel and by DOD transferring funds into or out of the DWWCF to pay for combat fuel losses or other higher priorities, among other things. As we noted in our report, DOD revised its cash management policy to require a positive cash balance throughout the year and an adequate ending balance to support continuing operations into the subsequent year.¹³ According to this revised policy, in setting the

¹⁰Failure to maintain a positive cash balance may result in a violation of 31 U.S.C. § 1341, the Antideficiency Act, which prohibits federal employees from obligating or expending amounts in advance of or in excess of amounts available in an appropriation or fund unless authorized by law.

¹¹We previously reported that DOD transferred about \$3 billion from the DWWCF to other DOD appropriation accounts throughout fiscal year 2016 to reduce the cash balance. Additionally, because of an excess cash balance in the DWWCF, Congress rescinded \$1.037 billion from the DWWCF in fiscal year 2016.

¹²GAO, *Defense-Wide Working Capital Fund: Action Needed to Maintain Cash Balances within Required Levels*. [GAO-17-465](#) (Washington, D.C.: June 30, 2017).

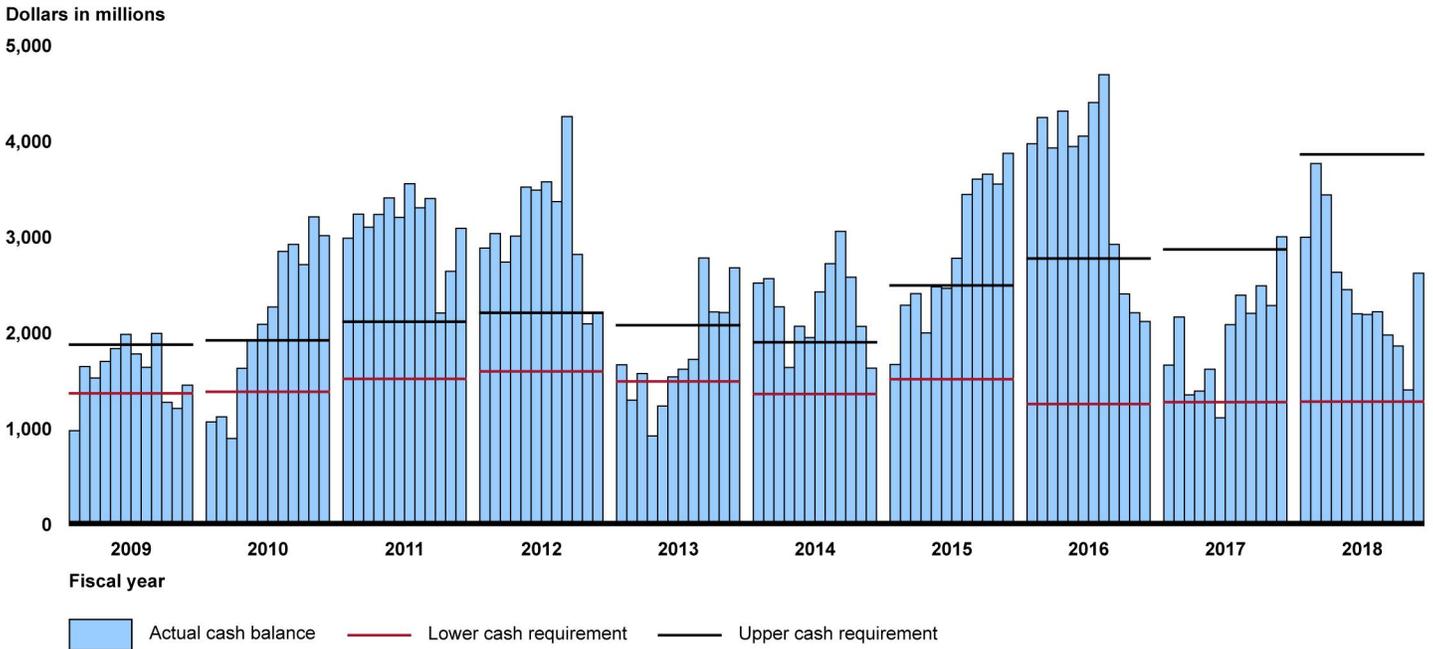
¹³See DOD 7000.14-R, *Financial Management Regulation*, vol. 2B, chap. 9 (July 2016 Draft). Although the update has not yet been officially published, the DWWCF is implementing the case management policies in the draft regulation, as instructed by the Office of the Under Secretary of Defense (Comptroller).

cash requirement goals, DOD working capital funds are to consider four elements: (1) the rate of disbursement, which is the average amount disbursed between collection cycles; (2) the range of operation, or the difference between the highest and lowest expected cash levels based on budget assumptions and past experience; (3) risk mitigation, which requires some amount of cash beyond the range of operations to mitigate the inherent risk of unplanned and uncontrollable events; and (4) reserves, which are cash amounts held for known future requirements.¹⁴

DOD officials said they are in the process of adding additional guidance to the DOD Financial Management Regulation about when DOD managers should use available tools to help ensure that monthly cash balances are within the targeted upper and lower cash requirements, as we recommended in our 2017 report. For this report, we updated the 2017 analysis to include the DWWCF's reported monthly cash balances and targeted upper and lower cash requirements for fiscal years 2017 and 2018, as shown in figure 3. For fiscal year 2017, the monthly cash balances were above and below the targeted upper and lower cash requirements one time each, and for fiscal year 2018 the targeted upper cash requirement was raised and the monthly cash balances were all within the revised targeted upper and lower cash requirements.

¹⁴This draft revised policy has given DOD additional discretion in setting the cash requirements for working capital funds to take into consideration the additional cash needed to cover the day-to-day volatility in the cash balance. DOD has subsequently broadened the range of the targeted upper and lower cash requirements in fiscal years 2016 through 2018.

Figure 3: The Defense-Wide Working Capital Fund’s Reported Cash Balances Compared to Targeted Upper and Lower Cash Requirements for Fiscal Years 2009 through 2018, by Month



Source: GAO analysis of Defense-Wide Working Capital Fund (DWWCF) cash data. | GAO-20-65

Note: In addition to being required to recover the full cost of goods and services provided, the DWWCF agencies maintain a cash balance that falls within a targeted range of upper and lower cash requirements established for the fiscal year.

Key Operating Principles for Effective Management of Working Capital Funds

In our prior work, we identified four key operating principles to guide the management of working capital funds. These key operating principles call for (1) working capital fund self-sufficiency, which includes establishing transparent pricing; (2) clearly delineated roles and responsibilities; (3) performance measurement; and (4) built-in flexibility to obtain customer input and meet customer needs.¹⁵ As we describe later in this report, each of these key operating principles has three underlying components describing specific actions agencies should take to adhere to the principle. For further information about each key principle and its components, see appendix I.

¹⁵GAO-12-56.

Defense Agencies Have Processes to Set Rates That Are Designed to Cover Costs but Are Not Transparent in Their Pricing

We found that DFAS, DISA, and DLA have applied two of the three components of the key operating principle for working capital fund self-sufficiency by setting rates that are designed to cover actual costs and establishing a management review for rate setting. However, despite taking steps intended to allocate costs equitably among their customers, DFAS, DISA, and DLA have not fully applied the third component of the key operating principle by establishing pricing methodologies that are transparent to their customers.

Defense Agencies Have Processes to Set Rates That Are Designed to Recover Actual Costs and Have Established Management Review for Rate Setting

DFAS, DISA, and DLA each develop budget proposals annually that are designed to recover their projected costs, while also accounting for any gain or loss from previous years. The three DWWCF agencies generally set rates that are intended to mitigate prior year gains or recover all prior year losses in the current fiscal year of execution, although they can spread the return actions over several fiscal years to minimize the impact on customers from rate fluctuations.

The rate-setting processes used by DFAS, DISA, and DLA include management reviews. Each agency's management reviews and approves the budget proposals for its DWWCF activities during the budget formulation process. The agencies then send the budget proposals to the Office of the Under Secretary of Defense (Comptroller) for further review and approval, and the Office of the Under Secretary of Defense (Comptroller) issues a memo finalizing the rates to be charged by DFAS, DISA, and DLA during the fiscal year.

Defense Agencies Use Multiple Approaches in Setting Rates and Allocating Costs

DFAS, DISA, and DLA each use multiple approaches to set rates on an annual basis and adjust these rates, as appropriate, during DOD's programming and budget development process.¹⁶ All three agencies include direct and indirect costs in their rates, and these costs vary due to differences in the agencies' missions, including the goods and services they provide.¹⁷ In general, the DWWCF agencies describe direct costs as those costs that can be directly attributed to an output and a customer. For example, DFAS officials told us that DFAS includes the cost of the labor that supports civilian pay services for a customer as a direct cost. DISA officials said that DISA includes the cost of servers as a direct cost. DLA officials indicated that materiel costs, such as the cost to acquire fuel or a spare part, are considered direct costs. Alternately, the three agencies describe indirect costs as costs that cannot be attributed to one specific output and customer. For example, costs for information technology systems that support multiple customers, supervisory staff that support more than one customer, and general and administrative (overhead) costs such as a DWWCF agency's general counsel services or physical facility maintenance are all indirect costs.

DFAS, DISA, and DLA set rates during DOD's annual programming and budget development process. The three DWWCF agencies begin the process of setting rates approximately 18 months prior to the fiscal year in which the rates will be applied. Setting rates in advance helps ensure that adequate resources are requested in the customers' fund accounts to pay the established rates and prices. The Office of the Under Secretary of Defense (Comptroller) reviews and approves finalized rates for a particular fiscal year in a rate memo circulated during the prior fiscal year. DFAS, DISA, and DLA use a combination of the following three

¹⁶The Planning, Programming, Budgeting, and Execution process is the annual resource allocation process for DOD within a quadrennial planning cycle.

¹⁷The DWWCF agencies vary in how they describe direct and indirect costs. For this report, we developed high-level descriptions of direct and indirect costs that we applied to all three agencies. For example, DFAS has two categories for costs that are not direct costs: indirect costs and general and administrative costs. For this report, we considered all costs that were not direct costs to be indirect costs.

approaches when setting the rates.¹⁸ Table 2 shows instances in which each of the three DWWCF agencies use the following rate-setting approaches.

- **Per Unit:** Determines a specific dollar rate per unit that, when multiplied by the projected workload, will produce revenue sufficient to recover the full costs, including direct and indirect costs, of providing the good or service.
- **Portion of Total Costs:** Charges a portion of the agency’s total costs (both direct and indirect costs) of providing a service based either on the proportion of total workload projected for a specific customer or a uniform percentage across all customers.
- **Percentage Markup on Direct Costs:** Adds a fee based on a percentage of the direct costs of a service as a proxy for expected indirect costs.

Table 2: Examples of Goods and Services That Use Each Rate-Setting Approach

| Agency | Per unit | Portion of total costs | Percentage of markup on direct costs |
|--|--|---|--|
| Defense Finance and Accounting Service (DFAS) | Pay and accounting services | Legacy accounting systems | Non-core/emerging mission workload ^a |
| Defense Information Systems Agency (DISA) ^a | Most computing services (excluding reimbursable services) and some telecommunications services ^b | Several telecommunications services | Some computing services (reimbursable services), some telecommunications services, and enterprise acquisition services |
| Defense Logistics Agency (DLA) ^c | Energy management, distribution, and most document services (excluding invoicing and electronic document access) | Disposition and some document services (invoicing and electronic document access) | Materiel supply chains |

Source: GAO Analysis of Department of Defense (DOD) information. | GAO-20-65

^aAccording to officials from those agencies, DFAS’s non-core/emerging mission workload and DISA’s reimbursable services are services that do not fit into those agencies’ standard rate structures.

^bFor Telecommunications Services, total costs also include a percentage markup to cover indirect contract management costs for the Defense Information Technology Contracting Organization.

^cDLA provides global distribution and warehousing services for consumable materiel through its distribution supply chain; reuse, recycling, and disposition of excess materiel through its disposition services; and weapon systems and troop support materiel through its materiel supply chains. All three

¹⁸DOD’s Financial Management Regulation identifies three methods the DWWCF uses for rate-setting purposes based on the nature of an activity—percentage markup on cost, direct labor hour, and specific unit of output—but does not require agencies to use all three methods. We have summarized these approaches in this report in the categories described below.

business segments are part of DLA's Supply Chain Management activity group. Unlike for the other goods and services it provides through the Defense-Wide Working Capital Fund (DWWCF), DLA receives some amounts annually appropriated to the DWWCF to cover the cost of its disposition services.

DFAS, DISA, and DLA officials described their approaches to allocating costs when setting rates. DFAS allocates costs to each of the services it provides and to each customer using those services through 29 predetermined business rules. DISA groups its services by the costs associated with providing them and allocates these costs to the services in each group based on factors such as the cost of equipment used to provide each service. Similarly, DLA uses various methods to allocate indirect costs to some or all of DLA's goods or services based on factors such as the number of employees supporting the provision of a given good or service and the total sales of that good or service. In each case, these costs are then included in the rates DFAS, DISA, and DLA charge customers for each good or service. See appendixes II through IV for more information on each agency's rate-setting approach.

The Defense Agencies Have Adjusted Some Rate-Setting Methodologies to Be More Equitable, but Their Methodologies Are Not Transparent

We found that DFAS, DISA, and DLA have taken steps intended to establish an equitable pricing methodology. However, customers from the military departments told us, and our review of related documentation provided at rate briefings and cost summits found, that the information they receive regarding the pricing of goods and services is not transparent. Officials from all three DWWCF agencies described efforts to more equitably allocate costs associated with a given good or service to the customers who use that good or service, as described below.

- DFAS, for fiscal year 2019, changed its method for allocating the costs of its facilities to its customers in an effort to more equitably allocate these costs. Previously, the costs for each DFAS facility were charged directly to the customers whose work was performed in that facility. Since the costs of facilities differ and customers do not choose the location that provides their service, DFAS changed this methodology so that customers now pay a uniform percentage of their direct costs to cover the total cost of DFAS facilities.
- DISA, for fiscal year 2017, changed the pricing structure for Defense Information System Network Infrastructure Services in response to recommendations from two DOD internal reviews. The structure changed from one designed to encourage adoption of the network

across DOD to a consumption-based model that aligns customer billing with consumption so that customers have greater control over their costs. According to DISA officials, this change has enhanced collaboration between DISA and its customers, providing customers more frequent inventories of the services they require so that the customers can determine that the bills for those services reflect their requirements.

- DLA is implementing two changes to the pricing methodology it uses for distribution services, part of its Supply Chain Management activity group. The first change, which DLA refers to as distribution price equitability, was implemented during fiscal year 2017. This pricing methodology allocates overhead costs to reimbursable distribution services (special services not included in DLA's standard rate structure). Previously, only rate-driven distribution services were charged for overhead. DLA proposed the second change, market basket pricing, for implementation in fiscal year 2020. Market basket pricing changes this pricing from being based solely on the weight of the items being distributed to a method that considers the level of effort required by DLA to distribute the items. For example, bulky, fragile, and hazardous items will be charged higher rates than small, easy-to-ship items.

While we found that DFAS, DISA, and DLA have taken steps intended to establish an equitable pricing methodology, military department officials from the offices we contacted said that they lack visibility into the factors that determine their costs at one or more of the three defense agencies. Specifically, they said they had a limited understanding of the types of indirect costs that are included in the rates they are charged and how those costs are allocated, the specific changes that have been made to the methods used to set rates, or how changes in the customer's use of the services, which would also change an agency's workload, would affect overall costs. DFAS, DISA, and DLA have produced documentation for their customers to explain their rates and have developed ways to communicate with their customers—for instance, through the use of customer liaisons. However, officials from the military departments told us this documentation does not contain the level of detail they need to fully understand the rates. For example,

- *DFAS.* Navy and Army officials we spoke with regarding DFAS said that their departments lack visibility into how DFAS's rates and bills are calculated because DFAS informational briefings do not describe the types of costs included in rates and how those costs are calculated and allocated to customers. As a result, officials said they

are confused by why declines in their use of DFAS's services have not resulted in reduced costs. These officials said that this information would make it easier for them to determine how to manage their costs and verify that costs are equitably allocated and reflect usage.¹⁹

- *DISA*. Air Force officials we interviewed regarding DISA told us that DISA does not provide sufficient pricing transparency because, although DISA has provided some documentation of its rates, this documentation does not explain the methodology used to calculate the rates and the costs included in those calculations. Although Army officials who discussed DISA said that DISA rate briefings provide the level of information necessary for customers, the Air Force officials said that this lack of information on how DISA calculates rates makes it difficult for the Air Force to determine how it can manage its costs with DISA or whether the rates it pays reflect the costs of the services it uses.²⁰
- *DLA*. Navy and Air Force officials we interviewed regarding DLA told us that DLA does not provide sufficient pricing transparency despite the rate briefings DLA conducts for its customers. Although the Army officials who discussed DLA said that the rate briefings provide sufficient information for customers, the Navy officials told us that the lack of detailed information on the costs included in DLA's rates makes it difficult for the Navy to determine how to lower its costs. They also said this lack of information prevents them from determining whether the rates they pay actually reflect the costs of the services they use, as intended. Similarly, the Air Force officials told us that DLA's communication regarding its market basket pricing initiative, discussed during the DLA briefings, was confusing and did not include all the information they needed to prepare their budget, such as when the change would be implemented and how the initiative would affect the Air Force's costs. Officials noted that, despite initially being told by DLA that the Air Force would experience a reduction in its distribution costs as a result of this initiative, they subsequently learned through a

¹⁹Officials from the Department of the Air Force did not comment on the transparency of DFAS's pricing.

²⁰Officials from the Department of the Navy did not comment on the transparency of DISA's pricing.

Resource Management Decision that the Air Force's costs would increase instead.²¹

DFAS, DISA, and DLA officials told us they make efforts to communicate with their customers and to improve the transparency of their rates. For example, DFAS officials noted that they have one-on-one discussions with each of their customers during the customer rate briefings. DISA officials said that they respond to customer questions regarding rates and share information on the costs included in those rates. DLA officials said they discuss rates at a variety of customer forums and share documentation of changes to their rate-setting methodologies, such as market basket pricing, with customers. Officials from the military departments acknowledged these efforts by the DWWCF agencies to share information. However, as described in the examples above, officials told us that one or more of the agencies have not provided them with the information needed to fully understand their costs, to have assurance that costs are being allocated fairly, or to identify actions they could take to affect their overall bills, in some cases, despite requests for more detailed cost information. In addition, DFAS, DISA, and DLA provided us copies of documents that they present at rate briefings and cost summits to share information about their pricing methodologies with their customers. In our review of those documents, we found that they contained high-level information, such as the rates themselves and the estimated workloads, and did not contain detailed information about the types of costs included in the rates and how those costs are calculated. For example, although DLA provides its cost recovery rate for the materiel supply chains in its rate briefing documentation, the documentation does not provide information on the specific costs that go into that rate. As a result, based on these documents, we also were not able to fully understand the agencies' costs and how those costs are allocated among their customers.

By providing more complete and transparent information on methodologies used to calculate rates, the costs used in those calculations, and how changes in workload affect a customer's rates, DFAS, DISA, and DLA could improve their communication with their customers and allow their customers to better understand and make

²¹Resource Management Decisions are documents containing the decisions by the Secretary of Defense reflecting broad strategic trades related to the program and resource levels identified in the Program Objectives Memorandum. The Program Objectives Memorandum is the final product of the programming process within DOD which displays resource allocation decisions.

decisions to help them manage the costs of the goods and services that they obtain. Such information would also better inform customers of any changes to the assumptions underlying rates and the impact those changes might have on their future costs.

DWWCF Agencies Delineate Roles and Responsibilities, Measure Performance, and Assess Resource Requirements and Customer Needs

We found that DFAS, DISA, and DLA have applied all of the components of the three remaining key operating principles for effective management of working capital funds. These principles relate to delineating roles and responsibilities, measuring performance, and assessing resource requirements and customer needs.²² By implementing these principles, the DWWCF agencies are better positioned to:

- Promote a clear understanding of who will be held accountable for specific tasks or duties, reduce the risk of mismanaged funds and tasks or functions “falling through the cracks,” and educate customers about whom to contact if they have questions.
- Measure their operational performance, assess their performance against strategic goals, and identify opportunities to improve performance.
- Enable customers to provide input about working capital fund services or voice concerns about their needs, enable agencies to prioritize customer demand, and enable agencies to use resources most effectively.

DWWCF Agencies Clearly Delineate Roles and Responsibilities

We found that all three DWWCF agencies have fully applied the three components of the principle for clearly delineating roles and responsibilities in that they define key areas of authority and responsibility, segregate duties to reduce fraud, and have a management review and approval process.

Define key areas of authority and responsibility. DFAS, DISA, and DLA define key areas of authority and responsibility and provide customers with clear information on who to contact if they encounter

²²[GAO-12-56](#).

issues or have questions. DFAS defines the responsibilities of key offices, such as those responsible for tracking revenue, in its *Doing Business with DFAS* catalog of services. This document lists points of contact, specific to each customer, who can provide support and address customers' questions.²³ DFAS also maintains service level and audit agreements with its customers, called mission work agreements, to document the specific level of effort and service it will provide. DISA's instructions define the roles and responsibilities for key officials and offices involved in managing the agency's DWWCF activities.²⁴ DISA also provides contact information for its customer account representatives in its DWWCF Rate Book and on its website. DLA's customer assistance handbook explains the roles of different offices within DLA and contains contact information for each of DLA's activity groups and for customer-specific representatives. DLA also defines roles and responsibilities of interagency groups in the performance-based agreements it signs with the military departments and services. For example, an agreement between the Department of the Army and DLA defines roles and responsibilities for the Partnership Agreement Council, the organization that addresses and prioritizes issues related to improving logistics coordination between DLA and the Army.²⁵

Segregate duties to reduce error or fraud. DFAS, DISA, and DLA segregate duties across their organizations and document this segregation. DFAS documents the segregation of responsibilities for tracking and recording transactions for each of its service offerings in its *Doing Business with DFAS* catalog of services. For example, DFAS's Retired and Annuitant Pay section tracks the number of individuals serviced under those pay systems, and DFAS's Central Revenue Office records these transactions in DFAS's billing system. DISA describes its processes for segregating duties in the documentation of its working capital fund disbursements and collections processes. For example, when DISA charges a customer agency, an accounts receivable technician records the billing information and a certifying officer verifies and certifies the transaction. DLA documents its segregation of key roles and responsibilities for authorizing, processing, and reviewing transactions according to DOD and DLA guidance. For example, the DOD manual that outlines sales accountability and documentation processes for energy

²³DFAS, *Doing Business with DFAS Catalog of Services Fiscal Year 19* (Sept. 1, 2018).

²⁴DISA Instruction 600.30.4, *Defense Working Capital Fund for DISA* (Sept. 24, 2012).

²⁵Performance Based Agreement: Headquarters, Department of the Army, G4 and Headquarters, Defense Logistics Agency (October 2015).

commodities assigns responsibility to DLA Energy for ensuring that DLA customers meet the criteria or have received waivers to purchase fuel through DLA, while DLA Transaction Services provides activity codes to authorized customers to manage their transactions.²⁶ Additionally, individual fuel handlers at DLA Energy stock points are required to record customer data for sales and credits on a source document.

Establish a management review and approval process. DFAS, DISA, and DLA have established management review and approval processes to promote the appropriate tracking and use of funds. DFAS documents its processes for tracking and reviewing transactions in its *Doing Business with DFAS* document. DISA describes the review of transactions in its documentation of its funds disbursements and collections processes. Each of DLA's activity groups tracks transactions and funding using DLA's accounting system of record—the Enterprise Business System. However, each group uses its own unique order validation process that is documented for each DLA activity group.

Defense Agencies Measure Performance

We found that all three DWWCF agencies are applying the three components of the key operating principle for measuring performance in that they have established performance measures and goals, aligned performance measures with strategic goals, and established a management review of DWWCF performance.

Establish performance measures and goals. DFAS, DISA, and DLA have each established performance measures and goals. DFAS uses financial and mission-focused performance measures, called business models, which include metrics for service timeliness and accuracy, among others. DISA has operational performance metrics, such as service downtime, and collects customer feedback on service provision through its Mission Partner Engagement Office. DLA establishes performance measures and corresponding thresholds in the performance-based agreements it signs with its customers from the military departments and services. These performance measures include materiel availability and backorders, among other measures.

²⁶DOD Manual 4140.25, vol.10, *DOD Management of Energy Commodities: Sales Accountability and Documentation Management* (March 2, 2018).

Align performance measures with strategic goals. DFAS, DISA, and DLA have performance measures that are aligned with their strategic goals.²⁷ Each DWWCF agency is responsible for maintaining positive cash balances sufficient to allow their operations to continue uninterrupted. To achieve this, all three agencies monitor their monthly cash balances and whether each of its activity groups is experiencing gains or losses. DFAS, DISA, and DLA also have aligned operational performance measures with their strategic goals as illustrated by the following examples.

- DFAS’s Fiscal Year 2017-2021 Strategic Plan identifies achieving cost, schedule, and performance targets that support delivery of best value services. DFAS monitors the timeliness and accuracy of its services reflecting this strategic outcome in its performance measurement. For example, DFAS measures the percentage of commercial payments it processes accurately and the percentage of military pay problem cases that it resolves in a timely manner.
- DISA’s Strategic Plan 2019-2022 states that optimizing enterprise services and capabilities to minimize costs while delivering high availability, among other benefits, is a strategic objective. To that end, DISA monitors data center and equipment availability through performance measures such as the average number of minutes of facility downtime per fiscal year.
- DLA’s Strategic Plan 2018-2026 identifies strengthening readiness and lethality as its highest priority line of effort. DLA monitors how its own performance affects readiness of critical weapon systems using its Service Readiness Dashboard, which includes a measure for the number of weapon systems that are non-mission capable due to DLA supply items being unavailable.

**Defense-Wide Working Capital Fund
Midyear Rate Changes**

Agency officials said that rates are generally fixed for the entire fiscal year, but the Office of the Under Secretary of Defense (Comptroller) can approve midyear rate changes if required. For example, we previously reported that the Defense Logistics Agency (DLA) collected about \$3.7 billion more from the sale of fuel than it cost in fiscal year 2015 because of lower fuel prices. Conversely, during fiscal year 2018, DLA’s cost of procuring fuel increased significantly due to increases in the price of the fuel procured from the market. As a result, in April 2018, DOD increased the rate from \$90.30 per barrel to \$115.92 per barrel to cover its costs.

Sources: GAO, *Defense-Wide Working Capital Fund: Action Needed to Maintain Cash Balances within Required Levels*, GAO-17-465 (Washington, D.C. June 30, 2017) and GAO analysis of Department of Defense (DOD) budget information.

Establish management review of working capital fund performance. DFAS, DISA, and DLA regularly monitor and have management reviews of agency performance against these financial and mission-related performance measures. Officials from each agency said they review the financial performance of the agencies’ activities throughout the year the programs and budgets will be executed to identify how differences between budgeted rates and actual costs affect the fund’s gains, losses, and cash balances. This allows them to coordinate with the Office of the

²⁷We did not assess all performance measures used by DWWCF agencies for their alignment with strategic goals. The measures discussed in this section are examples.

Under Secretary of Defense (Comptroller) to propose price changes when needed, although officials said that a midyear rate change is rare (see sidebar). The agencies also regularly review their non-financial performance based on the previously described measures to identify areas for improvement.

Defense Agencies Build in Flexibility to Obtain Customer Input and Meet Customer Needs

We found that all three DWWCF agencies are applying the three components of the key operating principle of building in flexibility to obtain customer input and meet customer needs by communicating with customers regularly and in a timely manner, developing processes to assess resource needs, and establishing processes to prioritize requests for service.

Communicate with customers regularly and in a timely manner.

DFAS, DISA, and DLA each routinely communicate with customers through annual rate briefings, customer forums, surveys, and other meetings. These meetings enable these agencies to provide high-level rate information to their customers and discuss the goods and services that their customers will need in the coming budget year. For example, DFAS communicates with the military services' budget offices through an annual briefing at a meeting hosted by the Office of the Under Secretary of Defense (Comptroller) and surveys finance officers and end-user customers on their satisfaction with military pay services. Similarly, DISA holds routine meetings at the working group and senior official levels to discuss service offerings, among other things.²⁸ In addition to its biannual cost summits where DLA discusses its pricing strategies with representatives from the military services, the Office of the Under Secretary of Defense (Comptroller), and the Office of the Under Secretary of Defense for Acquisition and Sustainment, DLA also holds an annual demand planning summit with the military services to discuss their projected requirements for the upcoming budget year.

²⁸DISA manages the Defense Information System Network, the secure telecommunications network used by DOD, through its Telecommunications Services and Enterprise Acquisition Services activity group.

Develop process to assess resources needed to meet changes in customer demand. DFAS, DISA, and DLA each take steps to communicate with customers regarding future demand and requirements. All three agencies have customer-specific representatives that obtain information on future requirements and facilitate communication between the agencies and their customers. DFAS uses client executive liaisons to resolve issues and collect information about customer needs for its goods and services. DISA uses its Mission Partner Engagement Office to address customer concerns and conduct surveys about customer needs. DLA has national account managers that represent each military service and facilitate DLA's engagement with the services regarding requirements and customer service representatives with select customers to meet their specific needs for DLA's goods and services.

Establish process to prioritize requests for services. DFAS, DISA, and DLA each have processes to adjust resources in response to the needs of their customers. This primarily occurs during the budget formulation process. DFAS officials told us that labor accounts for about 75 percent of the agency's costs, and management can decide to adjust its workforce resources depending on customer needs, often by shifting personnel and workload among customers, temporarily hiring additional staff, or reducing staffing levels through attrition. DISA's Strategic Resourcing Council is responsible for addressing issues such as resourcing strategies for existing and emerging programs. DLA uses its Enterprise Operations Planning Council, a group of DLA executives responsible for actively balancing customer needs and supply chain constraints, to ensure that resources are aligned with customer requirements during the budget formulation process.

Conclusions

The agencies whose operations are financed through the Defense-Wide Working Capital Fund have applied all but one of the components of the key operating principles for effective management of working capital funds—establishing a transparent and equitable pricing methodology, a component of the principle of ensuring self-sufficiency by recovering the agency's actual costs. Transparent pricing helps ensure that customers understand their costs and can make choices to manage these costs. Officials from the military departments—the largest customers of DFAS, DISA, and DLA—said they lack visibility into the types of costs included in their rates and some do not understand how changes to rate-setting methodologies or defense agency workload can affect their overall costs.

By providing this information to customers, DFAS, DISA, and DLA would better equip them to reduce their costs and improve efficiency. Further, DOD would have greater assurance that the DWWCF was operating as intended.

Recommendations for Executive Action

We are making the following three recommendations to DOD:

The Secretary of Defense should ensure that the Director of the Defense Finance and Accounting Service provides customers with more complete information on the agency's rate-setting methodologies in rate documentation, briefings, and other forums where rates are discussed, including the costs included in rates, how those costs are calculated, and how changes in DFAS's workload affect customers' overall costs. (Recommendation 1)

The Secretary of Defense should ensure that the Director of the Defense Information Systems Agency provides customers with more complete information on the agency's rate-setting methodologies in rate documentation, briefings, and other forums where rates are discussed, including the costs included in rates, how those costs are calculated, and how changes in DISA's workload affect customers' overall costs. (Recommendation 2)

The Secretary of Defense should ensure that the Director of the Defense Logistics Agency provides customers with more complete information on the agency's rate-setting methodologies in rate documentation, briefings, and other forums where rates are discussed, including the costs included in its rates, how it calculates those costs, and how and when proposed changes to its rate-setting methodologies will affect customers' overall costs. (Recommendation 3)

Agency Comments and Our Evaluation

We provided a draft of this report to DOD for review and comment. In an email accompanying its written comments, DOD concurred with our recommendations. In the department's written comments, DFAS, DISA, and DLA stated that they intend to take steps to provide their clients with additional information on rates. These steps include reaching out to customers to better understand their information needs and providing

additional information on potential pricing methodology changes. DOD's comments are reprinted in appendix V. DOD also provided technical comments during this review, which we incorporated, as appropriate.

We are sending copies of this report to the appropriate congressional addressees and the Secretary of Defense. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact Elizabeth Field at (202) 512-2775 or fielde1@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix VI.



Elizabeth A. Field
Director, Defense Capabilities and Management

Appendix I: Key Operating Principles for Managing Working Capital Funds

Table 3: Key Operating Principles for Managing Working Capital Funds (WCF)

| Principle | Components of principle | Examples of evidence supporting principle |
|---|---|--|
| 1. Ensure self-sufficiency by recovering the agency's actual costs Transparent and equitable pricing methodologies allow agencies to ensure that rates charged recover agencies' actual costs and reflect customers' service usage. If customers understand how rates are determined or changed including the assumptions used, customers can better anticipate potential changes to those assumptions, identify their effect on costs, and incorporate that information into budget plans. A management review process can help to ensure the methodology is applied consistently over time and provides a forum to inform customers of decisions and discuss as needed. | Establish transparent and equitable pricing methodology | Published price sheets for services are readily available. Documentation of pricing formulas supports equitable distribution of costs. |
| | Set rates to cover agency's actual costs of providing service | Pricing methodology and accompanying process ensures that, in aggregate, charges recover the actual costs of operations. |
| | Establish management review for rate setting | Management review process allows fund managers to receive and incorporate feedback from customers. Discussions with customers confirm an understanding of the charges and that they are viewed as transparent and equitable. |
| 2. Clearly delineate roles and responsibilities Appropriate delineation of roles and responsibilities promotes a clear understanding of who will be held accountable for specific tasks or duties, such as authorizing and reviewing transactions, implementing controls over WCF management, and helping ensure that related responsibilities are coordinated. In addition, this reduces the risk of mismanaged funds and tasks or functions "falling through the cracks." Moreover, it helps customers know who to contact in the event they have questions. | Segregate duties to reduce error or fraud | Written roles and responsibilities specify how key duties and responsibilities are divided across multiple individuals/offices and are subject to a process of checks and balances. This should include separating responsibilities for authorizing transactions, processing and recording them, and reviewing the transactions. |
| | Define key areas of authority and responsibility | Written description of all WCF roles and responsibilities in an accessible format such as a fund manual. Discussions with providers and clients confirm a clear understanding. |
| | Establish management review and approval process at the functional or activity level that ensures appropriate tracking and use of funds | A routine review process exists to ensure proper execution of transactions and events. |

**Appendix I: Key Operating Principles for
Managing Working Capital Funds**

| Principle | Components of principle | Examples of evidence supporting principle |
|--|--|--|
| 3. Measure performance | | |
| <p>Performance goals and measures are important management tools applicable to all operations of an agency, including the program, project, or activity level. Performance measures and goals could include targets that assess fund managers' responsiveness to customer inquiries, the consistency in the application of the funds' rate-setting methodology, the reliability of cost information, and the billing error rates. Performance measures that are aligned with strategic goals can be used to evaluate whether, and if so how, WCF activities are contributing to the achievement of agency goals. A management review process comparing expected to actual performance allows agencies to review progress towards goals and potentially identify ways to improve performance.</p> | <p>Establish performance measures and goals</p> | <p>Performance indicators and metrics for WCF management (not just for the services provided) are documented.</p> |
| | <p>Align performance measures with strategic goals</p> | <p>Indicators or metrics to measure outputs and outcomes are aligned with strategic goals and WCF priorities.</p> |
| | <p>Establish management review of WCF performance</p> | <p>WCF managers regularly compare actual performance with planned or expected results and make improvements as appropriate. In addition, performance results are periodically benchmarked against standards or "best in class" in a specific activity.</p> |
| 4. Build in flexibility to obtain customer input and meet customer needs. | | |
| <p>Opportunities for customers to provide input about WCF services, or voice concerns about needs, in a timely manner enable agencies to regularly assess whether customer needs are being met or have changed. This also enables agencies to prioritize customer demands and use resources most effectively, enabling them to adjust WCF capacity up or down as business rises or falls.</p> | <p>Communicate with customers regularly and in a timely manner</p> | <p>Established forum, routine meetings, and/or surveys solicit information on customer needs and satisfaction with WCF performance.</p> |
| | <p>Develop process to assess resources needed to meet changes in customer demand</p> | <p>Established communication channels regularly and actively seek information on changes in customer demand and assess the resources needed to accommodate those changes.</p> |
| | <p>Establish process to prioritize requests for services</p> | <p>Established management review process that allows for trade-off decisions to prioritize and shift limited resources needed to accommodate changes in demand across the organization.</p> |

Source: GAO-12-56 Defense Management. | GAO-20-65



Appendix II

Defense Finance and Accounting Service Rate-Setting Methods for Services Provided through the Defense-Wide Working Capital Fund

Background

DFAS reported receiving total Defense-Wide Working Capital Fund orders for services valued at approximately \$1.4 billion in fiscal year 2018. DFAS employs around 12,000 civilian personnel and provides services to DOD and other federal entities through a single activity group—Finance and Accounting Services.

Services Provided: DFAS provides centralized finance, accounting, human resources, and financial systems management services. DFAS categorizes its services into three types: rate-based services (which include military and civilian pay services and accounting services), direct systems reimbursements (i.e., legacy accounting systems), and support-to-others (i.e., reimbursable services that are outside of DFAS’s core mission or reflect emerging mission workload).

Indirect Costs: DFAS differentiates between two types of indirect costs: (1) *indirect* costs that are necessary to support DFAS’s direct mission but are not direct costs because they support multiple types of work or customers (e.g., information technology network infrastructure, senior operations management, and facilities costs) and (2) *general and administrative* costs that support DFAS as a whole and are not linked to specific services (e.g., costs for DFAS’s internal review office and other headquarters-related costs).

Cost Allocation and Rate-Setting Methodology

Approach to Allocating Costs: The Defense Finance and Accounting Service (DFAS) establishes rates for each of the services it provides. DFAS first links direct costs to each service and to each customer benefitting from that service. Then, DFAS applies 29 predetermined business rules to allocate indirect costs, which include mission-related indirect costs and general and administrative costs. These business rules identify costs associated with specific combinations of mission-related indirect costs necessary to provide a service and then apply a “fair-share” percentage of general and administrative indirect costs, which allows DFAS to determine the rates it needs to charge to recover all costs. General and administrative costs associated with supporting the entire DFAS organization are allocated at a uniform percentage within DFAS’s rates for all systems, services, and customers based on total direct costs.

Approaches Used to Calculate Rates for DFAS Services: DFAS uses three approaches to bill customers and recover its costs for its services:¹

- 1. Per Unit:** DFAS determines a specific dollar rate per unit that, when multiplied by the projected workload, will produce revenue sufficient to recover the direct costs and mission-related and general and administrative indirect costs of providing the good or service. DFAS uses this approach to set rates for its rate-based services, as described below.
 - **Rate-based Services.** DFAS charges a given customer a standard rate for each service that includes direct and indirect costs as allocated by its predetermined business rules. For civilian pay services, the number of units sold is based on the number of active civilian pay accounts in a given month (e.g., the number of civilian leave and earnings statements generated). For accounting services, the number of units sold is based on the number of labor hours DFAS employees recorded supporting a given task and customer.
- 2. Portion of Total Costs:** DFAS charges a portion of the agency’s total legacy systems costs (direct costs and both mission-related and general and administrative indirect costs) of providing a service based on the proportion of total workload projected for a specific customer. DFAS uses this approach for its direct systems reimbursement services, as described below.
 - **Direct Systems Reimbursement.** DFAS charges customers a percentage of the total costs—including direct and both types of indirect costs—of each legacy accounting system based on each customer’s portion of total system usage.

¹In addition to considering costs, DFAS incorporates adjustments to mitigate prior year operating results, whether gains or losses, when setting rates.

3. **Percentage Markup on Direct Costs:** DFAS adds a percentage markup to its direct costs in support of non-core or emerging mission workload to recover general and administrative indirect costs of the associated support. DFAS uses this approach for its support-to-others services, as described below.
 - Support-to-Others. DFAS charges customers the actual direct cost of providing a support-to-others service plus the general and administrative percentage markup.



Appendix III

Defense Information Systems Agency Rate-Setting Methods for Services Provided through the Defense-Wide Working Capital Fund

Background

DISA reported receiving total Defense-Wide Working Capital Fund (DWWCF) orders for services valued at approximately \$7.5 billion in fiscal year 2018. DISA employs around 8,700 military and civilian personnel and provides its services through two activity groups: Computing Services and Telecommunications Services and Enterprise Acquisition Services.

Services Provided: Computing Services operates the DISA Data Centers, which provide mainframe and server processing operations, data storage, and other information technology services and support across the Department of Defense (DOD). Telecommunications Services provides secure telecommunications services, including the Defense Information Systems Network. Enterprise Acquisitions Services provides contracting services for information technology and telecommunications acquisitions from the commercial sector and contracting support to the Defense Information Systems Network programs and other customers through DISA's Defense Information Technology Contracting Organization.

Indirect Costs: These include costs that are associated with a particular service, such as facilities costs, and those that are associated with support provided to all services, such as personnel support. Contract management costs are included for all services but are recovered differently.¹ The indirect costs included in rates vary among the different services DISA provides.

Cost Allocation and Rate-Setting Methodology

Approach to Allocating Costs: The Defense Information Systems Agency (DISA) groups its services by the costs associated with providing them. These costs are specific to the service being provided and are influenced by factors such as the cost of equipment used to provide the service. Computing Services has a large collection of billing rates, tailored to the services provided to a customer, such as mainframe and server processing; storage; and other services. Approximately half of DISA's business in Telecommunications Services is for the Defense Information Systems Network, for which DISA sets a standard rate to recover costs. The remaining half is for reimbursable services that cover services such as commercial satellite phones, instant message services, global videoconferencing services, and support for secure portable electronic devices (both smartphones and tablets).² The commercial satellite communications program recovers costs through a management fee that is added to the direct contract costs. According to DISA officials, cost reimbursable services are those services that are not included in DISA's standard offerings and thus do not have a standard rate. DISA recovers the cost for these services, including direct, indirect (overhead), and general and administrative costs, and the total cost is negotiated with customers up front.

Approaches Used to Calculate Rates for DISA Services: DISA uses three approaches for calculating rates:³

1. **Per Unit:** DISA determines a specific dollar rate per unit that, when multiplied by the projected workload, will produce revenue sufficient to recover the full costs, including direct and indirect costs, of providing the good or service. DISA uses this approach for most Computing Services and some Telecommunications Services.
 - **Computing Services.** DISA calculates most of its Computing Services rates by dividing the total costs of providing a service by total projected units. Total costs of a service comprise direct and indirect costs, including general and administrative costs.

¹According to DISA officials, within Computing Services, contract management costs are embedded in the rates. Within Telecommunications Services, contract management costs are recovered in addition to the rate through application of the Defense Information Technology Contracting Organization fee. For Enterprise Acquisition Services, contract management costs are also recovered via the Defense Information Technology Contracting Organization fee.

²DISA provides the communications capability for satellite phones, not the phones themselves, and it recovers the costs for this service under the Enhanced Mobile Satellite Services program. Rates for this program are based on the number of devices at the time the current unlimited usage contract was awarded in fiscal year 2013 plus a fair share of infrastructure costs.

³In addition to considering costs, DISA incorporates adjustments to mitigate prior year operating results, whether gains or losses, when setting rates.

- Telecommunications Services. DISA's mobility program, which provides support for portable electronic devices, recovers costs by charging a rate per device per month. Similarly, DISA's cross-domain services, which provide the ability for customers to transfer information across different security domains (unclassified and classified systems) at a price for each filter supported.
2. **Portion of Total Costs:** DISA charges a portion of its total costs, including direct and indirect costs, of providing a service based on the proportion of total workload projected for a specific customer. DISA uses this approach for several of its Telecommunications Services.
- DISA's Telecommunications Services charges customers a portion of the total costs for the Defense Information Systems Network based on each customer's portion of total network usage. Total costs includes bandwidth, circuits, maintenance, sustainment costs, network support and operations labor, outage monitoring, and contract management, among others.
 - This approach is also used for DISA's Global Video Services (video teleconferencing capabilities) and Organizational Messaging Services (command and control messaging).
3. **Percentage Markup on Direct Costs:** DISA adds a percentage markup on its direct costs as a proxy for indirect costs. DISA uses this approach to calculate some rates for its Computing Services and for its Telecommunications Services and Enterprise Acquisition Services activity groups.
- Computing Services. There are some services within the Computing Services activity group which DISA charges on a reimbursable basis, such that customers pay the direct cost of the service provided plus an additional percentage of the direct cost to cover general and administrative costs.
 - Telecommunications Services and Enterprise Acquisition Services. DISA charges the customer for the full cost of the contract plus an additional percentage of the direct costs to cover DISA's indirect costs associated with contract management through the Defense Information Technology Contracting Organization. This fee ranges from 1.75 to 2.5 percent of the contract amount and is based on the expected support costs for associated information technology systems, billing support personnel and systems, financial management, and space and facility costs.⁴ This standard contracting fee may change from year to year, but it remains fixed within any given year.

⁴Although DISA's Telecommunications Services charges customers a portion of the total costs for the Defense Information Systems Network based on each customer's portion of total network usage (the portion of total costs approach), these costs also include a percentage markup to cover indirect contract management costs for the Defense Information Technology Contracting Organization.



Appendix IV

Defense Logistics Agency Rate-Setting Methods for Goods and Services Provided through Defense-Wide Working Capital Fund

Background

DLA reported receiving total Defense-Wide Working Capital Fund (DWWCF) orders for goods and services valued at approximately \$40.6 billion in fiscal year 2018. DLA employs around 26,000 military and civilian personnel. DLA provides its services through three activity groups: Energy Management, Supply Chain Management, and Document Services.

Services Provided: DLA provides fuel and other energy commodities through its Energy Management activity group; consumable materiel (i.e., supplies and parts), distribution services for this materiel, and disposition services for excess property through its Supply Chain Management activity group; and printing, electronic document management and invoicing, and other document services through its Document Services activity group.

Indirect Costs: These include costs for information technology systems, facilities, and labor that support the provision of multiple goods and services. Costs for information technology systems and labor that provide enterprise-level support to all of DLA (such as DLA's accounting system and headquarters staff), among other costs, are also included. The indirect costs included in rates vary among the different goods and services that DLA provides.

Cost Allocation and Rate-Setting Methodology

Approach to Allocating Costs: The Defense Logistics Agency (DLA) allocates direct costs to the individual good or service for which the costs were incurred. For indirect costs, DLA determines whether each cost is associated with providing specific goods or services (such as labor that supports a specific materiel supply chain) or is associated with supporting DLA as a whole (such as the DLA general counsel). DLA uses various methods to allocate these indirect costs, taking into account factors such as the number of employees supporting the provision of a given good or service and the total sales of that good or service.

Approaches Used to Calculate Rates for DLA Services: DLA uses three approaches for calculating rates:¹

- 1. Per Unit:** DLA determines a specific dollar rate per unit that, when multiplied by the projected workload, will produce revenue sufficient to recover the full costs, including direct and indirect costs, of providing the good or service. DLA uses this approach for energy management, distribution, and some document services, as described below.
 - **Energy Management.** DLA charges a standard price per barrel of fuel which includes the product cost (i.e., projected direct cost for DLA to purchase a barrel of fuel) and non-product costs (i.e., transportation, terminal operations, sustainment, etc.).
 - **Distribution.** DLA charges four different weight-based processing rates that are calculated by dividing the total processing costs (excluding transportation costs) for items in each weight category by the projected number of units shipped for each category.²
 - **Defense-Wide Working Capital Fund Agencies Apply Most Key Operating Principles but Should Improve Pricing Transparency Wide Area Workflow).** DLA charges a per-unit rate calculated by dividing the total projected costs associated with a given service by the total projected units to be sold. Total costs can include direct and/or indirect costs.³
- 2. Portion of Total Costs:** DLA charges a portion of its total costs, including direct and indirect costs, of providing a service based either on the proportion of total workload projected for a specific customer or

¹In addition to considering costs, DLA incorporates adjustments to mitigate prior year operating results, whether gains or losses, when setting rates.

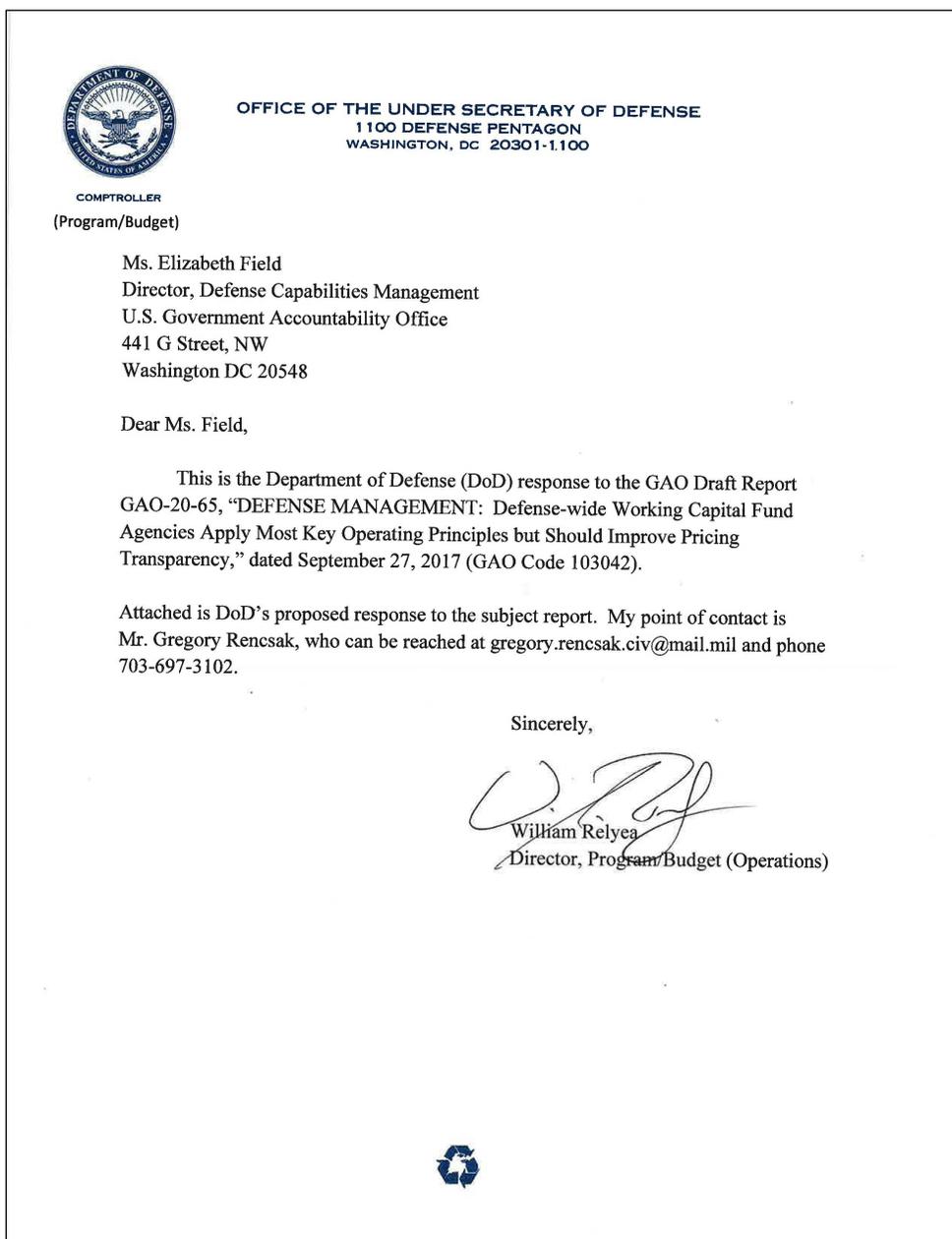
²DLA will change its distribution services pricing structure for fiscal year 2020. Market basket pricing changes distribution pricing to a method that considers the level of effort required by DLA to distribute the items and is not based solely on the weight of the items being distributed. For example, bulky, fragile, and hazardous items will be charged higher rates than small, easy-to-ship items.

³According to DLA officials, Document Services will transfer rate setting and invoicing to Supply Chain Management in fiscal year 2020. DLA did not provide information on how, if at all, this will affect the rate-setting methodologies used for Document Services.

a uniform percentage across all customers. DLA uses this approach for disposition and some document services, as described below.

- Disposition. DLA charges each customer a portion of the total direct and indirect costs of providing disposition services based on the customer's portion of total disposition service usage. When applicable, DLA subtracts the revenue it generates through the sale of excess property, reimbursements it receives from customers for hazardous waste management, and funding it receives for Overseas Contingency Operations from the total costs before assigning costs to customers.
 - Document Services Electronic Document Access and Wide Area Workflow (Invoicing). For Electronic Document Access, DLA charges all customers a uniform percentage of its total costs for providing that service. For Wide Area Workflow, DLA charges each customer a portion of the total costs based on the customer's portion of total system usage.
3. **Percentage Markup on Direct Costs:** DLA adds a percentage markup on the cost to acquire each good (i.e., the product cost) as a proxy for non-acquisition costs associated with that good (i.e., non-product costs). DLA uses this approach for its weapons systems and troop support materiel supply chains.
- Materiel Supply Chains. To calculate the cost recovery percentage, DLA divides the projected non-product costs for each materiel supply chain by the projected product costs of that materiel supply chain. The rate charged is the sum of the product cost of the good and an additional percentage of this product cost corresponding to the markup percentage.

Appendix V: Comments from the Department of Defense



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

COMPTROLLER
(Program/Budget)

Ms. Elizabeth Field
Director, Defense Capabilities Management
U.S. Government Accountability Office
441 G Street, NW
Washington DC 20548

Dear Ms. Field,

This is the Department of Defense (DoD) response to the GAO Draft Report GAO-20-65, "DEFENSE MANAGEMENT: Defense-wide Working Capital Fund Agencies Apply Most Key Operating Principles but Should Improve Pricing Transparency," dated September 27, 2017 (GAO Code 103042).

Attached is DoD's proposed response to the subject report. My point of contact is Mr. Gregory Rencsak, who can be reached at gregory.rencsak.civ@mail.mil and phone 703-697-3102.

Sincerely,


William Relyea
Director, Program/Budget (Operations)



Attachment 1:

Consolidated Department of Defense Response to GAO Draft Report GAO-20-65

GAO Recommendation 1:

The Secretary of Defense should ensure that the Director of the Defense Finance and Accounting Service provides its customers with more complete information on the agency's rate-setting methodologies in rate documentation, briefings, and other forums where rates are discussed, including the costs included in rates, how those costs are calculated, and how changes in DFAS's workload affect customers' overall costs.

DFAS Response:

DFAS provides detailed cost and rate information to customers each year in multiple venues including, but not limited to, their participation in our annual planning and programming process, customer bill briefs, and year of execution dialog to include review of their associated Customer View Model. DFAS Client Executive personnel maintain open dialog with our customers where if questions were to arise on rates and/or billing, these will be addressed accordingly. As had been requested by DFAS during the July 2019 Exit Conference, GAO included in the 27 September 'draft' report the list of customers who expressed concerns regarding our rate transparency where our Client Executive personnel will now reach out to the respective customers to obtain additional details to understand how we can fill the informational gap.

GAO Recommendation 2:

The Secretary of Defense should ensure that the Director of the Defense Information Systems Agency provides its customers with more complete information on the agency's rate-setting methodologies in rate documentation, briefings, and other forums where rates are discussed, including the costs included in rates, how those costs are calculated, and how changes in DISA's workload affect customers' overall costs.

DISA Response:

While we consistently strive for transparency with rates and cost development and we do communicate through a variety of venues, we will make every effort to improve dialog with our customers to ensure the correct people have a full understanding of DISA's methodologies used to develop their rates.

GAO Recommendation 3:

The Secretary of Defense should ensure that the Director of the Defense Logistics Agency provides its customers with more complete information on the agency's rate-

Attachment 1:

setting methodologies in rate documentation, briefings, and other forums where rates are discussed, including the costs included in its rates, how it calculates those costs, and how and when proposed changes to its rate-setting methodologies will affect customers' overall costs.

DLA Response:

DLA concurs with the recommendation and will include more detailed information in our annual rate briefing to OUSD(C) and Services regarding what is in our costs, how we calculate costs, and how and when changes would impact customers' overall costs. In addition, DLA conducts semi-annual Cost Summits and periodic DLA / Service Days with customers. As appropriate, topics will include potential pricing methodology changes and estimated cost impacts to customers, well in advance of implementation.

Services' Responses:

The Navy did not provide a response.

The Army concurs with no additional comments.

The Marine Corps has no comments to GAO draft report, GAO-20-65 (Code103042).

The Air Force provided a response to each recommendation.

AF Response to Recommendation 1: The Air Force does typically receive expected price increase information via DFAS rate briefings. The information provided is necessary to ensure the AF appropriately captures expected price changes in their budgets so in turn, their budgets estimates are accurate and the proper costs are passed to AFWCF customers, where applicable. The AF did not receive price increase information from DFAS in time to incorporate the information into the FY21 Budget Estimate Submission. DFAS costs are not a significant cost to the AFWCF. When updates are not provided, the AF uses standard inflation to estimate expected price increases. The GAO audit recommends that DFAS provides details related to why the prices are changing. Total transparency in operational changes that impact costs may not be necessary. AF needs enough information to properly defend their budgets and understand how their actions may impact future costs. While detailed information may be useful in helping DFAS customers understand how their actions may allow future DFAS cost reductions, and corresponding decreases in DFAS prices, it may not be necessary for DFAS customers to understand low level details in DFAS operational changes that have minor impacts on DFAS costs which the customer cannot control.

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The Air Force Material Command, who pays the DLA distribution bills also recently reported that detailed execution information that had previously been provided via the DLA website, has recently been discontinued. As a result AFMC no longer has the level of details necessary to perform detailed analysis.

Agency Comment Letter

Text of Appendix V: Comments from the Department of Defense

Page 1

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Appendix VI: GAO Contact and Staff Acknowledgments

GAO Contact

Elizabeth A. Field at (202) 512-2775 or fielde1@gao.gov

Staff Acknowledgments

In addition to the contact named above, Alex Winograd (Assistant Director), Karyn Angulo, Martin de Alteriis, Garrick Donnelly, Christopher Gezon, Felicia Lopez, Keith McDaniel, Susan Murphy, Suzanne Perkins, Carol Petersen, Richard Powelson, Lauren Shaman, Kevin Walsh, and Doris Yanger made key contributions to this report.

Appendix VII: Accessible Data

Data Tables

Data Table for Figure 2: Breakdown of Fiscal Year 2018 Orders of Goods and Services by Defense-Wide Working Capital Fund Activity Group and Customer

| Service | Army | Navy | Air Force | Other |
|---------------------------------|--------------|------------|--------------|--------------|
| Document Services | 39.9 | 100.9 | 29.2 | 130.4 |
| Finance and Accounting Services | 516.2 | 317.1 | 269.8 | 297.5 |
| Information Services | 2048.0 | 799.6 | 1134.3 | 3506.3 |
| Energy Management | 1158.1 | 2430.1 | 4825.6 | 2428.3 |
| Supply Chain Management | 9059.4 | 7360.9 | 6239.8 | 6754.8 |
| Total | 12.8 billion | 11 billion | 12.5 billion | 13.1 billion |

Data Tables for Figure 3: The Defense-Wide Working Capital Fund's Reported Cash Balances Compared to Targeted Upper and Lower Cash Requirements for Fiscal Years 2009 through 2018, by Month

Actual Cash Balance.

| Year | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep |
|------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| 2009 | 982.3 | 1651.8 | 1532.6 | 1705.3 | 1841.1 | 1987.9 | 1784.6 | 1644.0 | 1998.3 | 1279.3 | 1215.1 | 1457.8 |
| 2010 | 1074.6 | 1126.9 | 901.7 | 1634.1 | 1921.4 | 2093.3 | 2274.0 | 2854.8 | 2928.2 | 2716.4 | 3214.6 | 3018.0 |
| 2011 | 2992.0 | 3242.8 | 3107.3 | 3240.3 | 3412.9 | 3209.7 | 3560.3 | 3309.8 | 3406.2 | 2210.3 | 2645.9 | 3096.0 |
| 2012 | 2889.3 | 3040.4 | 2742.9 | 3013.1 | 3526.4 | 3495.0 | 3579.9 | 3373.7 | 4261.8 | 2823.5 | 2098.7 | 2209.8 |
| 2013 | 1670.2 | 1301.3 | 1579.0 | 928.6 | 1240.2 | 1543.8 | 1623.9 | 1727.2 | 2785.7 | 2222.8 | 2216.6 | 2683.4 |
| 2014 | 2524.0 | 2569.4 | 2275.8 | 1642.6 | 2072.7 | 1955.9 | 2431.4 | 2726.1 | 3064.5 | 2584.6 | 2071.8 | 1635.7 |
| 2015 | 1673.9 | 2292.6 | 2413.9 | 2004.0 | 2485.9 | 2468.6 | 2782.4 | 3449.7 | 3608.2 | 3660.9 | 3557.4 | 3878.3 |
| 2016 | 3978.0 | 4251.8 | 3934.7 | 4318.7 | 3949.0 | 4057.0 | 4408.0 | 4698.5 | 2926.9 | 2410.8 | 2213.8 | 2122.5 |
| 2017 | 1668.3 | 2169.3 | 1356.8 | 1396.1 | 1624.3 | 1117.7 | 2089.8 | 2397.9 | 2208.4 | 2495.0 | 2289.1 | 3007.5 |
| 2018 | 3002.5 | 3772.3 | 3444.9 | 2637.0 | 2455.8 | 2203.5 | 2196.8 | 2225.1 | 1981.0 | 1866.8 | 1409.1 | 2627.2 |

Lower and Upper Cash Requirement.

| Year | Lower cash requirement | Upper cash requirement |
|-------------|-------------------------------|-------------------------------|
| 2009 | 1372.0 | 1881.0 |
| 2010 | 1388.0 | 1926.0 |
| 2011 | 1524.0 | 2120.0 |
| 2012 | 1602.0 | 2213.0 |
| 2013 | 1498.0 | 2083.0 |
| 2014 | 1366.0 | 1906.0 |
| 2015 | 1520.0 | 2499.0 |
| 2016 | 1261.0 | 2780.0 |
| 2017 | 1280.5 | 2874.2 |
| 2018 | 1286.0 | 3868.1 |

Related GAO Products

Document Services: DOD Should Take Actions to Achieve Further Efficiencies. [GAO-19-71](#). Washington, D.C.: October 11, 2018.

Defense-Wide Working Capital Fund: Action Needed to Maintain Cash Balances within Required Levels. [GAO-17-465](#). Washington, D.C.: June 30, 2017.

Bulk Fuel: Actions Needed to Improve DOD's Fuel Consumption Budget Data. [GAO-16-644](#). Washington, D.C.: September 12, 2016.

Department of Justice: Working Capital Fund Adheres to Some Key Operating Principles but Could Better Measure Performance and Communicate with Customers. [GAO-12-289](#). Washington, D.C.: January 20, 2012.

Intragovernmental Revolving Funds: Commerce Departmental and Census Working Capital Funds Should Better Reflect Key Operating Principles. [GAO-12-56](#). Washington, D.C.: November 18, 2011.

Federal User Fees: A Design Guide. [GAO-08-386SP](#). Washington, D.C.: May 29, 2008.

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